Corporate Control: A Comparative Examination of Corporate Law in Canada and the People's Republic of China

Qin Zhao

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CORPORATE CONTROL:
A COMPARATIVE EXAMINATION OF
CORPORATE LAW
IN
CANADA AND THE PEOPLE’S REPUBLIC OF CHINA

By

QIN ZHAO

Submitted in partial fulfillment of the requirements
for the degree of Master of Laws

at

Dalhousie University
Halifax, Nova Scotia
August, 1999

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This thesis examines the concept of corporate control in Canadian and Chinese business enterprises. Going beyond traditional studies of corporate governance, which are concerned principally with the relationship between shareholders and corporate managers, this thesis explores the ways in which corporate law in China and in Canada regulates and arbitrates the relationships among all corporate participants, in the context of the political, social, economic and cultural milieu in which corporate law and policy in both countries has evolved.

Through a comparative examination of corporate control issues under two specific corporate law regimes - that of the Canada Business Corporations Act (CBCA), and that of the Corporation Law of the People's Republic of China and China's Foreign Investment Enterprises Laws (collectively "China’s Corporate Laws") - several key observations emerge. The corporate control model embodied in the CBCA represents a modified capitalist model of corporate control, whereas China’s Corporate Laws represent an attempt to borrow corporate control experiences from western countries, and to integrate those experiences into the structure of Chinese corporations, while adhering to China's distinctive socialist political and economic regime. China’s Corporate Laws may thus be best understood as the product of a modified socialist model that adopts many western corporate law features without sacrificing the principles of China’s socialist regime.

This comparative study also illustrates a more general proposition: that regimes designed to regulate corporations necessarily vary across nations and cultures in order to address specific conditions and satisfy particular governmental objectives and cannot be regarded simply as means of facilitating productive enterprise. The unique approaches to corporate control in Canada and in China are rooted in the distinctively different politics, economies, histories, statutory traditions and cultural values of these two nations.
## ABBREVIATIONS

<table>
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<td>ALI</td>
<td>American Law Institute</td>
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<td>Asia Pacific L. Rev.</td>
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<td>Cal. L. Rev.</td>
<td>California Law Review</td>
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<td>CBCA</td>
<td>The Canada Business Corporations Act, R.S.C. 1985, c. C- 44</td>
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<td>CCL</td>
<td>Corporation Law of the People's Republic of China</td>
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<td>China's Corporate Laws</td>
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<td>Columbia Law Review</td>
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<td>Dey Report</td>
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<td>Implementing Regulations for the Law of the People's Republic of China on Chinese-foreign Equity Joint Venture</td>
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<td>J. Bus. Admin</td>
<td>Journal of Business Administration</td>
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<td>Journal of Chinese and Comparative Law</td>
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<td>Report from Standing Senate Committee on Banking, Trade and Commerce in August 1996 (chaired by Michael Kirby)</td>
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<td>L. &amp; Pol'y Int'l Bus.</td>
<td>Law and Policy in International Business</td>
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<td>Man. L. J.</td>
<td>Manitoba Law Journal</td>
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<td>Abbreviation</td>
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<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
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<td>NSTAQS</td>
<td>National Securities Trading Automated Quotation System</td>
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<td>Nw. U.L. Rev</td>
<td>Northwestern University Law Review</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>Plenary</td>
<td>The Third Plenary Session of the Eleventh Central Committee of the Communist Party of China in December 1978</td>
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<td>PRC</td>
<td>People's Republic of China</td>
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<td>SU</td>
<td>Soviet Union</td>
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<td>TSE</td>
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CHAPTER 1 INTRODUCTION

The corporation, as a legal structure for organizing economic activities, has existed in Western Europe and elsewhere for hundreds of years. Prior to the early twentieth century, corporations (in particular, business corporations) were not regarded as significant economic or political forces. The corporate form was initially adopted by business people generally to facilitate the pooling of capital from numerous investors. It is the relatively recent emergence of large multinational corporations and their predominant position in a state's economic and political life that has led to increased concerns about the regulation of their activities.

Corporate law in any country is shaped by a complex interplay of external and internal forces, which include the unique business, social, economic, political and cultural values of that country. This thesis will examine this inter-relationship between corporate law and such forces through a comparison of the corporate regimes in two distinctively different countries: Canada and China. This comparison will focus in particular upon the different approaches in these two countries to critical issues of corporate control.

1.1 The Concept of Corporate Control

The historical development of corporations from small corporations to large public corporations in a changing global economy has meant that the concept of corporate control has been in a state of flux. Research on corporate control in the early twentieth century was limited to studies of the relationship between investors and managers. The issue of corporate control in terms of the investor/manager relationship was first seriously
addressed by Berle and Means in their treatise *The Modern Corporation and Private Property*¹ in 1932. Five major types of corporate control were recognized in their work. They were: (a) one hundred per cent ownership control;² (b) majority control (i.e. over fifty per cent ownership control);³ (c) control through a legal device without majority ownership (e.g. the device of "pyramiding", issuing bonds or non-voting stock, or through voting trusts);⁴ (d) minority control (i.e. through attracting scattered owner proxies);⁵ and (e) management control.⁶ It was disclosed that in large public corporations, corporate control tended to move further away from ownership and ultimately lay in the hands of top managers.⁷ Later, Mace's field research in 1971 illustrated the management control phenomenon described by Berle and Means in reality: in large and medium-sized American corporations, presidents, rather than boards of directors, wield the corporate decision-making power.⁸ Thus, the concept of corporate control is no longer regarded simply as a function of ownership of voting shares but includes the capacity for mobilizing other shareholders and/or the occupation of powerful managerial positions in corporations.⁹


² *Ibid.* at 70.


⁵ *Ibid.* at 80.

⁶ *Ibid.* at 84.


⁸ M.L. Mace, *Directors: Myth and Reality* (Boston: Division of Research, Graduate School of Business Administration of Harvard University, 1971).

A year after the publication of The Modern Corporation and Private Property, Rohrlich in his work, Law and Practice in Corporate Control, studied the issue of corporate control from the perspective of the external controlling power exercised by the state and creditors over corporations, the relationship between majority and minority shareholders, legal remedies available to the minority shareholders, shareholders' communication, and the function of committees (i.e. the proxy-committee, the voting-trust, and the protective committee). The concept of corporate control in Rohrlich's treatise therefore was broadly defined and moved beyond the narrow issue of the relationship between shareholders and managers.

In recent years, the term corporate control is more often understood narrowly as corporate internal control, a conception relating to corporate internal management and

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11 Ibid. For the state, at 12 - 26; for the creditors, at 169 - 182. The term "controlling power" might be overstated. The power exercising by the state and creditors mentioned in Rohrlich's treatise over the corporate business is just influencing.

12 Ibid. at 27 - 54.

13 Ibid. at 96 - 168.

14 Ibid. at 55 - 64.

15 Ibid. at 65 - 95. Protective committee, in Rohrlich's treatise, is used for enhancing the right of holders of non-voting securities (such as bonds or non-voting classes of stock) to participate in corporate affairs. The protective committee is "self-constituted, willing itself into being." (Ibid. at 72) "Committee members need not have any personal interest in the security or the corporation, and it would seem that they may even have independent interests... But they may not make contracts for secret profits... The protective committee informally brought together takes its legal status, from the 'deposit agreement'..." In general, the protective committee in Rohrlich's treatise is a form standing halfway between the proxy and the voting-trust.

equivalent to another term - corporate governance. It appears that the term "corporate governance", addressing issues in connection with corporate objective, shareholders' rights, relationship between the majority and minority shareholders, the role of the board of directors, the powers and duties of directors and officers, oversight function in the board, and remedies, is widely accepted by the Canadian and US legal communities and more popular than the term "corporate internal control".\(^7\)

In the 1990s, research regarding corporate governance was widely conducted in a number of countries in order to improve corporate performance.

In 1992, the Committee on the Financial Aspects of Corporate Governance in the United Kingdom (UK) published its report relating to the corporate governance of public corporations: *Report of the Committee on the Financial Aspects of Corporate Governance*.\(^8\)

Since 1978, the American Law Institute ("ALI") has initiated a project of researching corporate governance. The fruit of the research campaign, ALI’s 1994 *Principles of Corporate Governance: Analysis and Recommendations*\(^9\) thoroughly examined corporate governance mechanisms in business corporations (particularly publicly held corporations) in America and raised constructive suggestions for further improving corporate governance.

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\(^7\) The term "corporate governance" appears more often than the term "corporate control" in legal literatures.


In 1994, the Toronto Stock Exchange (TSE) Committee on Corporate Governance in Canada also addressed the issue of corporate governance in its report, *Where Were the Directors? Guidelines for Improved Corporate Governance* ("Dey Report"), and proposed an effective corporate governance system for the stewardship of corporations in Canada. In 1995, the TSE passed a by-law requiring corporations incorporated in Canada and listed on the TSE to disclose their governance practices in their annual report or information circular and, to the extent those practices differ from the Guidelines, to explain why they differ.

In 1996, the Organization for Economic Co-operation and Development (OECD) Ministers at the meeting of the Council at Ministerial level required a study of corporate governance. As a result, a report - *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets* - was submitted by the Business Sector Advisory Group on Corporate Governance in 1998. Other non-governmental organizations, like the World Bank, also developed research in the 1990s on the subject of corporate control.

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21 The TSE and Institute of Corporate Directors issued a press release on June 17, 1999 to announce the first official follow-up study on how closely TSE listed companies were actually following the Dey Report. See *Report on Corporate Governance, 1999: Five Years to the Dey*, Online: TSE <http://tse.com/mregs/index.html> (date accessed: August 18, 1999). The study is based on detailed responses from 635 Chief Executive Officers of TSE-listed companies, representing a 51 per cent response rate.


Legal research on corporate governance in China, however, is not well developed. Impelled by economic reform, China in 1993 adopted its first national corporation law - Corporation Law of the People's Republic of China (CCL).²⁴ For the first time in the socialist People's Republic of China, the corporation, the legal creature of capitalist countries, became recognized in law as an economic organization and a device to serve in China's economic reform. But research regarding corporate governance of Chinese corporations is still in its infancy.

Since the concept of corporate control is in a state of fluctuation, there is no uniform definition of the term "corporate control" in Canada or China. It will be argued here that, though the corporate entity is a legal fiction, corporate control deals with relationships among people. Corporate control can be defined as the power exercised, directly or indirectly, by one or more persons, to exert a determining/controlling influence over the policies or the management of a corporation, through ownership, position, legal devices, statutory rights and/or remedies. The policies or the management of a corporation in turn impose influences upon people who have interests in the corporation no matter whether they are in the controlling position. On the other hand, such controlling power over the policies or the management of a corporation is embedded in, influenced by, and in turn influences the values of the society of which it is an integral part.

This broad definition of corporate control derives from the process of

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²⁴ Corporation Law of the People's Republic of China, adopted at the Fifth meeting of the Standing Committee of the Eighth National People's Congress on December 29, 1993 and effective as of July 1, 1994.

An English version is available online: China Internet Information Center: China's Economy and its Enterprises <http://www.china.org.cn/> (date accessed: June 20, 1999).
understanding conflicts among various corporate constituents struggling for controlling power of the corporation in the light of economic theory regarding rational human behavior. Gary Becker points out that all intentional behaviors of human beings can be understood as people pursuing goals as best they can subject to the constraints of the external world, that is "constrained maximization". 25

Employing the theory of "constrained maximization" to analyze the behaviors of corporate participants (that is, corporate shareholders and stakeholders), one can conclude that the conflicting interests of these participants and the struggle for corporate control among corporate participants arise from the limited resources of a corporation that cannot meet all wants of all such interested people. Shareholders anticipate maximizing their personal profits by receiving dividends from the corporation. Directors and officers anticipate bigger remuneration packages or salaries or some other end, such as professional ambition, prestige, or power from the corporation. 26 Employees expect from the corporation higher wages, better benefits, better working conditions and job stability. Creditors expect their debts from the corporation to be repaid with interest. Customers hope to receive better goods and services at lower prices. Local communities anticipate increase of employment and reduction of environmental problems. The expectations and interests among the corporate participants maybe conflicting and competing. In the meantime, the resources of the corporation are insufficient to satisfy all these competing demands. Corporate behaviors reflect either the discretion of corporate participants who


Gary Becker was awarded the Nobel Prize in Economics in 1992 for his work extending economic analysis to the research area of human behavior. For more detail of his work, please refer to The Economic Approach to Human Behavior (Chicago: University of Chicago Press, 1976).

26 Supra note 1 at 122.
have the determining/controlling power or the compromise between decision-makers and other corporate participants.

1.2 The Theme and Framework of This Thesis

The broadly defined notion of corporate control covers almost all areas of corporate law and also touches upon other bodies of law, including securities law, takeover law, tax law, and stock exchange regulations. This subject also invites an understanding of the process of how corporations are managed in reality, as well as how they ought to be managed in theory. The complex interplay of external and internal forces, and the role of societal values in shaping corporate law can be clearly illustrated by a comparison of the corporate laws of two countries with distinctly different political, social, and economic influences: Canada and China. Limited by time and space, this thesis will only examine corporate control issues in the context of two specific corporate law regimes: that of Canada's federal corporate statute, the Canada Business Corporations Act (CBCA)²⁷, and that of CCL and China's Foreign Investment Enterprises Laws (FIEs Laws)²⁸ (CCL and FIEs Laws are hereinafter collectively referred to as China's Corporate

²⁷ The Canada Business Corporations Act, R.S.C. 1985, c. C-44. CBCA is a quite appropriate example of Canadian corporate law for this comparative study since it is very similar to the corporate statutes found in most of Canadian common law provinces today and has been consciously followed by many Canadian provincial corporate laws.

²⁸ China's Foreign Investment Enterprises Laws refer to
- Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures (adopted on July 1, 1979 at the Second Session of the Fifth National People's Congress, and amended pursuant to the "Decision on Amendment of The Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures" passed on April 4, 1990 at the Third Session of the Seventh National People's Congress) (EJV Law);
Laws).

Given the significance of business corporations in a nation's economy, this thesis will only examine business corporations, that is, corporations with the objective of making profit incorporated under the CBCA and China's Corporate Laws. It will not deal with Canadian co-operative corporations, crown corporations, purely Chinese state corporations and administrative corporations. This comparative study of corporate control, as broadly understood, will be conducted from two perspectives: corporate internal power distribution in business corporations incorporated under the CBCA and under China's Corporate Laws and external public interest factors that affect corporate decision-making.

To illustrate, the comparative study of corporate internal power distribution comprises a comparative examination of corporate ownership structures, legal devices available to the majority and minority shareholders, the role of the board of directors,

- Law of the People's Republic of China on Chinese-foreign Cooperative Joint Ventures (adopted at the First Session of the Seventh National People's Congress on April 13, 1988, and promulgated by order No.4 of the President of the People's Republic of China on and effective from April 13, 1988) (CJV Law);
- Law of the People's Republic of China on Wholly Foreign-owned Enterprise (adopted by the Fourth Session of the Sixth National People's Congress on April 12, 1986) (WFOE Law); and

It should be noted that in terms of Chinese-foreign cooperative joint ventures, there are two forms under CJV law, that is, corporate joint ventures with legal person status and joint ventures without legal person status. In this thesis, cooperative joint ventures without legal person status are not subject to discuss given that they are not legal entities and get different management structure from corporations. Please note that although Hong Kong was transferred to China on July 1, 1997, the legal system adopted by Hong Kong, closely connected with British legal system, remains unchanged. China's Corporate Laws mentioned in this thesis do not include corporation law in Hong Kong.

²⁹ In addition, sole-shareholder corporations under the CBCA will not be considered because firstly, China's Corporate Laws does not permit the existence of sole-shareholder corporation; and secondly,
managerial officers, and employees, as well as the respective positions of corporate participants within the corporate internal hierarchy in corporate theory and in the business reality of Canada and China. With regard to external factors that affect corporate decision-making, I will address the role of state, market, creditors (focusing upon banks), courts and culture in influencing corporate behaviors in Canada and China.

The business corporation as a form of business association has been well established in Canada for a long period. The study of corporate control under the CBCA reveals a modified capitalism model of corporate control in Canada. Using the CBCA as a touchstone, through this comparative study, it will be observed that China’s Corporate Laws, which emerged during the age of China’s economic reform aimed at building a socialist market economy, borrow corporate control experiences from western countries and try to align western corporate experiences into the structure of Chinese corporations within the political and economic regime of this socialist country. China’s corporate control experience, in particular the internal corporate control provided by the CCL, reflects the merger of traditional socialistic models of enterprise management and the modern corporate control mechanisms of western countries. The study of corporate control under China’s Corporate Laws demonstrates a modified socialism model of corporate control.

A section-by-section technical comparison of the provisions of the CBCA and of China’s Corporate Laws would be incomplete and virtually meaningless because such comparative work ignores the impact of external environments and thus fails to recognize the critical connection between corporate control and the politics, economy, history, corporate control is not an issue in such corporations since the single shareholder effectively exercises all corporate power.
ideology and culture of a country. To avoid such unhelpful technical comparison and provide, rather, a context, Chapter 2 includes a general overview of the features of Canadian corporate law in the context of Canadian economic development, and the historical development of the CBCA. Chapter 3 provides a general overview of Chinese economic development, its relationship with the development of Chinese corporations and the historical development of China's Corporate Laws. Through the historical survey, it is observed that the CBCA was developed within a stable social environment and has a clear historical relationship to British corporate law, connected with Canada's early colonial history, as well as a current inclination to parallel American corporate legislation, reflecting more recent close economic integration with the United States. The appearance of China's Corporate Laws however is driven by the program of diversifying the ownership of enterprises in China's transitional economy. Under the pressure of attempting to promote efficient management of business and the desire of maintaining the socialist regime in China, China's Corporate Laws embrace western corporate experiences but at the same time preserve certain aspects of traditional socialist enterprise management.

Chapters 4 and 5 respectively address the topic of corporate control from an internal and external perspective. The diagram attached as Appendix I illustrates the structures outlined in Chapters 4 and 5.

Chapter 4 examines the law and practice of corporate internal control in Canadian and Chinese corporations. Shareholders nominally control the corporation through the ownership function. The comparative study of the corporate ownership structures in Canada and China demonstrates that Canadian and Chinese corporations have highly concentrated share ownership structures, and that closely held corporations dominate
Canadian and Chinese corporate markets. The Canadian corporate market is further characterized by high overlapping ownership and directors ties. Share structures provided by the CBCA and the CCL reflect different social environments, business practices and statutory traditions in Canada and China. The CBCA adopts a model of shareholders' democracy based on capital while pursuing fair treatment for the minority shareholders. CCL provides majority shareholders with extraordinary statutory rights in directing corporate business but neglects the protection of the minority shareholders. Although CCL also adopts the concept of shareholders' democracy based on capital, it is doubtful, based on an analysis of the provisions under the CCL, that Chinese shareholders' democracy can be solidly established on the basis of capital. Chapter 4 further looks at the role of the board of directors in a corporation's internal control and at the board's oversight function in Canada and China. Generally speaking, the boards of Canadian corporations have greater power than their counterparts in China in terms of corporate management. Considering the directors' power of directing corporate business, the CBCA and CCL both split the management and supervision function, although they accomplish this split in very different ways. In China, the division is made explicit by the adoption of a two-tier board system. In Canada, the division is somewhat more subtle, but is observed nevertheless. Chapter 4 also addresses the role of managerial officers, particularly the chief executive officer in Canada and the general manager in China. The chief executive officer of a large public corporation in Canada generally handles corporate strategic matters and directs corporate management while the general manager in Chinese corporations is usually in charge of corporate daily management and operation. Moreover, the comparative study of employees' collective power for controlling or influencing corporate management in Canada and China shows that under corporate laws,
Chinese employees generally have greater influencing power in corporate management (particularly in the area of employee welfare) than their counterparts in Canada.

Chapter 5 examines the issue of corporate control from an external perspective. Briefly, this chapter addresses the role of the state, market, creditors, courts and culture in influencing corporate management in Canada and China. In terms of the role of the state in corporate management, it is demonstrated that Chinese corporate business enterprises are subject to more influences from direct state intervention than Canadian corporations. As to the role of the market in influencing corporate decision-making, the thesis further subdivides the market influences, and specifically examines capital markets, corporate control markets, product/service markets, managerial service markets, as well as the function of media coverage. It is shown that generally Chinese markets do not play as great an influencing role as Canadian markets in terms of corporate decision-making given the infant market systems in today's China. Chapter 5 also examines the bank's role as a creditor and how banks affect corporate control in the two countries. Briefly, the banks' role in corporate control is limited in both Canada and China. With respect to courts and their influences upon corporate control, it is demonstrated that Canadian courts are normally exerting greater influencing powers upon corporate business than Chinese courts, particularly through the use of specific judicial and statutory remedies. The reason for this difference is attributable to different legal systems and legal traditions in Canada and China. As to the culture's influence upon corporate control, it is observed that the capitalist culture adopted by Canada tends to favor protection of private property rights and individualism. Canadian culture encourages a flexible business environment within which business people may seek to maximize their personal wealth through corporations. Today's socialist culture in China accords well with China's traditional cultural values
embodied in Confucianism. A high respect for hierarchy, emphasis on obligations rather than rights, orientation toward groups, and emphasis on rule by virtue rather than the law, as embedded in Confucianism culture, favor a socialist focus on protection of public property rights and collectivism.

Chapter 6 concludes the comparative study of the corporate control practices in Canada and China and points out that China's corporate control experiences merge concepts of socialist enterprise management with western modern corporate control experiences.
CHAPTER 2 THE CANADA BUSINESS CORPORATIONS ACT

The evolution and refinement of the CBCA, in a stable social environment, have been greatly influenced by British company law and American corporate law. The CBCA’s historical relationship with British company law may be traced to Canada's history, first as a British colony, then later as a member of the British Commonwealth. The strong American influences on the CBCA owe much to the increasing economic integration between Canada and the US since the end of World War II, an economic integration that has been expanded since the execution and implementation of the Canada-United States Free Trade Agreement (FTA)\(^{30}\) and the North American Free Trade Agreement (NAFTA),\(^{31}\) as well as increasingly interdependent commercial relationships in today's digital economy\(^{32}\) especially in North America.

Before Canadian confederation in 1867, the economy of colonial Canada was resource-based. The rich resources, especially the resources of cod, fur and timber,


\(^{32}\) Digital economy is an economy based on the digitization of information and communication infrastructure. It is a kind of economy based on knowledge. The digital economy mainly consists of electronic commerce and the information technology industries that make electronic commerce possible. The digital economy is changing how people work, communicate, consume and do business. It appears that the term “digital economy” is more often used in the US. While in other countries, like Canada, another term, “electronic economy” is more popular.
attracted European nations (in particular, Britain) to expand their political and economic power in this land. Corporations, as a form of economic power, appeared during the development of Britain's overseas exploration efforts as early as the 14th century. The growing need for establishing an economic institution for accumulating capital, handling credit, transferring funds, and limiting risks called for a more readily available corporate form.

The first general Act, the 1844 Joint Stock Companies Act in the UK, introduced incorporation by registration, the method that has remained in dominant use in the UK since then and subsequently became the standard model of incorporation in most of the Commonwealth. In terms of incorporation in Canada, the first Act of incorporation for indigenous commercial companies was passed in Canada in the 19th century. In 1849, the first general Act appeared in Canada, consisting of one Act for Upper Canada and another for Lower Canada to authorize incorporation of joint stock companies for


35 7 & 8 Vic. cc.110 & 111. See J.S. Ziegel et al., Cases and Materials on Partnerships and Canadian Business Corporations, 2nd ed. (Toronto: The Carswell Company Limited, 1989) at 98. However, the 1844 Joint Stock Companies Act withheld the privilege of limited liability.


37 12 Vic., c.56.

38 12 Vic., c.84.
construction of roads and bridges. In 1850, a broader general Act was passed. The appearance of the general Acts of incorporation responded to the needs of large capital intensive projects, like ship building, mining, mechanical and chemical business in Canada. The first Canadian general incorporation Act adopted by the federal Parliament appeared in the year 1869 and repealed the earlier pre-Confederation legislation.

Corporate law in Canada is under virtually concurrent federal and provincial jurisdiction. All Canadian provinces, except Quebec, operate under the common law based on British legal tradition. The common law recognized two principal forms of incorporation. One was incorporation by exercise of the royal prerogative, usually referred to as incorporation by letters patent, or royal charter; and the other was incorporation by private or general act of the legislature.

In addition to these fundamental British corporate law roots, Canadian corporate law today also owes much to U.S. models. The federal corporate law reforms in the 1970s proposed by Dickerson, Howard and Getz (Dickerson Committee) in *Proposals for a New Business Corporations Law for Canada*, led to significant changes in the CBCA. The Dickerson Committee drew upon the experiences of corporate law makers in the Australian states, New York, California, North Carolina and Ontario. Discarding the

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39 13 & 14 Vic., c.28 (Can., 1850).

40 32 & 33 Vic., c.13.

41 *Supra* note 35 at 97. It is noted that following 1844 Joint Stock Companies Act in the UK, the "registration" model also existed in Canada.


letters patent model and endorsing "enablingism" in terms of incorporation procedures; providing minority shareholders and creditors remedial safeguards for self-protection; eliminating useless procedures, providing directors and officers power to manage while imposing non-excludable obligations upon them, the CBCA paved a road that is workable for business people in Canada. The founding principles established under the CBCA, corporate personality, managerial power, majority rule and minority protection, demonstrate the style of corporate democracy and management effectiveness.

The reason that CBCA owes much to U.S. models lies in the fact of Canada's close business relationship with the US since World War II. It is witnessed that entering into the late 1980s, the Canadian and American economies have been even further integrated because of the implementation of FTA, NAFTA and the arrival of the digital economy. The FTA, which came into force on January 1, 1989, mainly concerned the gradual elimination of tariffs and reductions in non-tariff trade barriers on goods between Canada and the US. The FTA was later incorporated into the NAFTA.

44 Ibid. at 18.


46 Ibid. at 102. The UK, since joining the Common Market in 1972, has began to move closer to continental perception in order to harmonize with other European countries. Moreover, it appears that UK abandons some old conception slower than American jurisdictions. In addition, UK lacks an North American style of securities commission. These all together may determine Canada's strong inclination to American jurisdiction in the contemporary age.

47 Supra note 32.

48 Department of Foreign Affairs and International Trade, "Trade Negotiations and Agreements: Opening Doors to the World, Canada's International Market Access Priorities 1999" Online: <http://www.dfaitmaeci.gc.ca/ma-nac/doorsworld/04-e.asp#4.1> (date accessed: August 8, 1999). The NAFTA did not affect the phase-out of tariffs under the FTA, which was completed on January 1, 1998. To that date, virtually all tariffs on Canada-US trade in originating goods were eliminated. Some tariffs remain in place for certain products in Canada's supply-managed sectors (e.g., dairy and poultry), as well as sugar, dairy, peanuts and cotton in the United States.
foster increased trade and investment between Canada, United States and Mexico, expands the free trade from goods to other important sectors (like investment, trade in services, intellectual property, competition, and the cross-border movement of business persons). It contains an ambitious schedule for tariff elimination and reduction of non-tariff barriers, as well as comprehensive provisions on the conduct of business in the free trade area. Under the NAFTA, North America is increasingly viewed as a single market. The international trade and investment flows between Canada and the US since the implementation of NAFTA suggest that the NAFTA has played a pivotal role in increasing trade and investment between Canada and the US. The economies of Canada and the US are increasingly interconnected given that Canada and the US are each other's largest trading partners.

The rapid growth of the computer industry and the remarkable development of computer networking in recent years are leading Canada into an era of digital economy. Canada's ambition of becoming a world leader in the development and use of electronic

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49 Ibid. It is not totally accurate to exclude trade with Mexico. Generally speaking, total trade and investment between Canada, Mexico and the United States has increased substantially since the NAFTA was implemented in 1994. Canada's total merchandise trade with the US and Mexico surpassed a half a trillion dollars in 1998. Two-way merchandise trade between Canada and Mexico grew by 8.6 percent, reaching $8.9 billion in 1998. Canadian merchandise trade with the United States is up 11.1 percent over the same period, reaching $505 billion in 1998.


Canada's merchandise exports to the United States alone support over 2 million Canadian jobs, and generate 30.4 percent of Canada's GDP. Fully 83.7 percent of Canadian merchandise exports are destined for the United States. On the other hand, the US exported $234.2 billion in goods into Canada.

51 Supra note 32.
commerce has been stated by the government of Canada for establishing Canada into the most connected nation in the world. With the assistance of advanced technology, corporations will expand their significance in the international economy by promoting marketing, increasing production, reducing costs, increasing communication, and developing new services. It is very likely that in this environment, Canadian corporate law and American corporate law will become even more closely aligned.

In Canada, the significance of the CBCA is growing with Canadian business. As of December 31, 1998, there were 162,168 corporations incorporated under the CBCA. Over 50 per cent of the Financial Post's top 500 business corporations in Canada were constituted in accordance with the CBCA. The CBCA framework has since been copied by most Canadian provinces. Other commonwealth jurisdictions have also been influenced by the CBCA.

The CBCA, then, may be regarded as a mature and sophisticated modern corporate law, adopted within a stable social environment, and embodying principles

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53 The data was provided by Lee Duford of Strategies Client Services of Industry Canada through email on March 23, 1999. (Contact detail: 235 Queen Street, 1st Floor, East Tower, Ottawa, Ontario K1A OH5, Tel: 613 - 954 5031, Fax: 613 - 954 1894; Internet: hotline.service@ic.gc.ca).


55 J.S. Ziegel, "The CBCA - Twenty Years Later: Where Do We Go From Here" in Faculty of Law, McGill University, Conference Meredith Lectures 1994/95, Corporations at the Crossroads (Montreal: McGill University, 1995) 3 at 5.

56 For instance, New Zealand even adopted a CBCA style and incorporated substantial provisions of the CBCA in its Companies Act 1993. Companies Act 1993 (commenced on July 1, 1994) Online:
found in the corporate law regimes of other leading industrial nations, chiefly the U.S. and the U.K. Moreover, the profound influences of the CBCA, both within Canada and elsewhere, attest to its success as a modern corporate framework and make it an appropriate touchstone against which to consider the more recent corporate law initiatives of the People's Republic of China.

CHAPTER 3 CORPORATE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA

The appearance and development of China's Corporate Laws are closely connected with China's economic and political development and ideological transformation. It is beyond the scope of this thesis to examine in detail the historical development of the Chinese economy, politics and ideology and their association with China's Corporate Laws. This chapter, however, will provide a brief history of the development of corporations in the context of China's economic development and the historical development of China's Corporate Laws.

3.1 The Context of Economic Development and Incorporated Companies

As outlined in Chapter 2, the historical development of the CBCA took place in a stable economic and political environment and involved a process of legislative reform and refinement in connection with a shift from primarily UK models to US models. The appearance and evolution of Chinese Corporate Laws, however, took place in the midst of significantly shifting political and economic circumstances. The Chinese Corporate Laws therefore unavoidably reflect these changes.

The People's Republic of China (PRC) was inaugurated on October 1, 1949 after the Chinese Communist Party's victory in the civil war against the National People's Party. The existence of a powerful neighboring ally, the Soviet Union (SU), allowed the government of the Chinese Communist Party to follow the SU's model in its efforts to

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57 National People's Party, in Chinese, Guo Ming Dang. Members of the National People's Party fled to Taiwan after their defeat in the civil war.
build a socialist regime in China. With financial and technical assistance from the SU, the Chinese government gradually established a Soviet-model economic system. Through centralizing a planning economy, collectivizing agriculture, eliminating private industry and trade, and nationalizing banks in the socialist transformation program, the central government virtually cleared all market forces in the 1950s. There were no private corporations pursuing profits in mainland China after 1956. Up to 1978, only two types of entities, distinguished by ownership, existed in mainland China: state-owned enterprises and collectively owned enterprises.

Rather than pursuing profits, state-owned enterprises and collectively owned enterprises under the planning economy were operated to meet production targets set by the government. The enterprises no longer cared about profits and losses since all profits would be channeled to state revenue and all losses would be shouldered by the state. The government exercised macro-control and micro-control to manage the enterprises. In terms of macro-control, the government controlled funds and materials that the enterprises needed for production. With regard to micro-control, production and sales of an

58 The program of socialist transformation of industry and commerce in the 1950s was started through formation of joint state-private enterprises (referred to as "state-capitalist") to deal with private establishments. In 1956, the final transformation (or nationalization) of such enterprises was accomplished by assuring private businessmen a fixed interest payment (regardless of profitability) in exchange for their waiving ownership and control of their companies. For a detail description, please refer to C. Riskin, China's Political Economy: The Quest for Development Since 1949 (New York: Oxford University Press, 1987) at 97.

59 P. Jiang & L.F. Fang, eds. New Edition of Course in Corporation Law (China: Law Publishing House, 1994) at 47. At the end of the 1940s and the early 1950s, there were around 1,300,000 private industrial and commercial associations in China. They were registered according to company law of the Republic of China (law issued by the government of the National People's Party). Among them, only 11,298 were registered corporations. 1954 Constitution of the People's Republic of China established the state policy of limiting capitalist ownership and "... gradually [replacing] capitalist ownership with ownership by the whole people." See Article 10 of Constitution of the People's Republic of China (1954).

enterprise were connected with governmental directive planning. The government, as the only representative of the whole people according to socialist theory, through its administrative organs, exercised decision-making power in the enterprises.

Central planning, however, requires too much information. Practically there are so many unforeseeable factors and not all information is obtainable. In the end, enterprises were unable to rely on the central government to allocate resources needed to carry out state plans. Accordingly, these enterprises began to pursue a strategy of self-reliance. This led to the hoarding of materials and the duplication of productive operations in localities. Self-reliance became a state policy during China's Cultural Revolution period (1966-76). During this period, the self-reliance policy meant:

1. full utilization of domestic resources, including labor and skill;
2. rejection of indiscriminate imitation of foreign methods in favor of accumulating indigenous experience suited to Chinese conditions;
3. reliance on domestic saving to finance capital accumulation; and

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61 In Chinese, Zi Ling Ji Hua.

62 The government arranges all matters relating to the enterprises, such as what to produce, how much to be produced, how to distribute, the sale prices, whether to borrow money and when to repay any loans. Centralizing planning economy had its positive contribution to China's economic development, however. It allowed China to concentrate its resources and investment on large-scale projects, which were necessary for rapid industrial growth. World Bank studies showed that as to net output, the real annual growth rate of China was around ten percent for the period from 1957 to 1979 which was above the average of other low- and middle-income countries. For detail, see World Bank. China: Socialist Economic Development, vol. I (Washington, DC: World Bank, 1983).


64 Cultural Revolution (1966-1976) is a program for purifying the communist party and cleaning capitalism and anti-socialism. During this period, class struggle was part of everyone's life. For detail: China News Digest International, The Visual Museum of the Cultural Revolution, online: China News Digest International <http://www.cnd.org/CR> (date accessed: March 24, 1999). The self-reliance policy caused China to alienate itself from the international market. One of the main reasons for promoting a self-reliance policy was that during the 1960s, diplomatic relation between China and the Soviet Union became worse due to issues relating to Taiwan, co-existence and border disputes. The Soviet Union withdrew its technical experts who had assisted China in establishing Chinese industry in the 1960s. Without external assistance, the Chinese government initiated self-reliance policy.

65 Ibid. at 205.
(4) establishment of a comprehensive industrial system in China.

Such policy emphasized a reliance on domestic resources (natural resources, funds and human capital) to develop the Chinese economy. Simply put, China adopted a "closed-door" economic policy during this period.

The Third Plenary Session of the Eleventh Central Committee of the Communist Party of China in December 1978 (Plenary) was recognized as an official sign that China had launched economic reform and opened up to the outside world. The Plenary communiqué was deemed "political enabling legislation" that made it possible to liberalize economic policy.

Since 1978, a widespread reform has been ongoing for establishment of a non-state sector economy (i.e. private, collective, and foreign invested economy), adjusting the distribution system, attracting foreign capital, decentralizing central administration, re-

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66 Chinese Communist Party’s policy plays a leading role in directing Chinese economic development. Such source of power comes from paragraph seven of the preamble of the Constitution of the People's Republic of China (adopted at the Fifth Session of the Fifth National People's Congress and promulgated for implementation by the Proclamation of the National People's Congress on December 4, 1982, as amended at the First Session of the Seventh National People's Congress on April 12, 1988, and again at the First Session of the Eighth of National People's Congress on March 29, 1993.) (1993 China's Constitution) It provides that, "Under the leadership of the Communist Party of China and the guidance of Marxism-Leninism and Mao Zedong Thought, the Chinese people of all nationalities will continue to adhere to the people's democratic dictatorship and the socialist road and to uphold reform and opening to the outside world, steadily improve socialist institutions, develop socialist democracy, improve the socialist legal system, and work hard and self-reliantly to modernize the country's industry, agriculture, national defense and science and technology step by step to build China into a strong, prosperous culturally advanced, democratic socialist nation. (emphasis added) An English translation of Constitution of the People's Republic of China is available online: Maryland University School of Law, ChinaLaw Website <http://www.qis.net/chinalaw/lawtran1.htm> (Date accessed: January 12, 1999)

67 K. Fukasaku, D. Wall & M. Wu, China's Long March to an Open Economy (Paris: OECD, 1994) at 24. The Communiqué of the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China (passed on December 22, 1978) (Beijing: People's Publishing House, 1978) at 7 (Chinese version). The Chinese Communist Party proclaimed a shift from class struggle to economic development and adopted a de-centralization policy. The Plenary communiqué further provided enterprises with expanding autonomy. The Plenary communiqué did not provide a reform blueprint. Instead, it required the state to
organizing industries, promoting foreign trade, lifting price controls, increasing enterprise autonomy, improving the financial system and re-arranging the tax system. The on-going economic reform has led to rapid economic achievements in China in a relatively short period.

The reform program, with its focus on economic reform, had no solid theory to support it at first. With the political and economic collapse of the SU and the eastern European socialist countries in the early 1990s, there was no precedent for the Chinese focus on economic construction. Some open-minded and pragmatic people (like Deng Xiaoping and Chen Yun) resumed power after this meeting.


The driving forces behind China’s reform campaign are different from that of eastern European socialist countries or the former Soviet Union. Instead of being pushed to the road of reform due to domestic macroeconomic crisis, China’s reform campaign was more or less spontaneous and closely connected with domestic political and economic factors. Two main factors could explain why the Chinese government initiated the reform campaign:

1) Politically, after the ten-year "culture revolution", the leading party in China, i.e. China Communist Party (CCP) had to take immediate action to re-establish its prestige in the state and regain trust from the Chinese people so as to foster its leadership status in China. The best and also the only way to achieve these goals was to enhance the state’s productivity and improve the material level of Chinese people's lives, so as to evidence that CCP is able to and will satisfy its promise to lead the whole Chinese people to reach prosperity, and

2) Economically, because of its isolation from western advanced technology, refraining from foreign capital and adhering to a central planning economy, the whole economic development was lagging behind developed countries. In order to be melted into global economy, China has to open up to the outside world and learn from other countries.

For a detailed description, see the World Bank, China: Reform and the Role of the Plan in the 1990s (Washington, DC: The World Bank, 1992) at 34.


government to follow in further building its socialist economy. In the process of trial, failure and re-trial, the economic reform in China gradually developed its own characteristics. The characteristics of China's economic reform are: gradualism, decentralization, and commitment to socialism. China's Corporate Laws, developed during the transitional economy, also reflect these features.

(1) Gradualism

Gradualism is reflected in two aspects: timing and geography. Usually, a reforming policy is gradually and nationally implemented over a relatively long period. As to timing, the reforming period starting from 1978 is still ongoing. With regard to geography, some districts were circled out as testing areas for implementing reforming policies. After assessment and the result of experimentation were observed, the central government could decide whether to adopt the model to the whole country or not. The process of establishing Special Economic Zones (SEZ) embodied the gradualism. In 1980, the central government of China approved for opening Shenzhen, Zhuhai, Shantou and Xiamen, the four SEZs in the South China. Up to the 1984, the central government approved another fourteen cities as opening cities for the reforming trials. The fourteen cities are: Dalian, Qinghuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai.

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70 An old Chinese saying applies well under such circumstances: feeling the stones to cross the river. The old saying was cited by Chinese leaders in describing reforms related to establishing a socialist market economy. It might be one of the reasons that Chinese government adopted a conservative and cautious attitude in almost all reforming areas.

71 Gradualism makes China avoid social shock symptom and ensures a relatively stable transition. Transition cost therefore largely reduced. On the one hand, people get orientation period; on the other hand, improvement, innovation or correction can be made from time to time in a relative long time period. The disadvantages, however, are unequal competition conditions between different areas; increased cost of enjoying growth attribute to reform; and unpredictable economic environment.


There are exceptional cases that cannot adopt gradualism and require an immediate change. For instance, clarifying role of central bank, distinguishing functions between commercial bank and non-bank financial institutions (i.e. trust institutions).

For a brief summary on reforms of China's financial system, see J.C.H. Chai, China: Transition to a Market Economy (New York: Oxford University Press Inc., 1997) at 118.

72 The process of establishing Special Economic Zones (SEZ) embodied the gradualism. In 1980, the central government of China approved for opening Shenzhen, Zhuhai, Shantou and Xiamen, the four SEZs in the South China. Up to the 1984, the central government approved another fourteen cities as opening cities for the reforming trials. The fourteen cities are: Dalian, Qinghuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai.
government then decided whether or not reforms should be extended to other areas.

Gradualism explains the current situation of business association laws in China: co-existence of enterprise laws that categorize entities according to ownership (e.g. all people owned enterprises, collectively owned enterprises, sino-foreign joint ventures and wholly foreign owned enterprises) and the CCL which adopts shareholding corporate structures borrowed from the western world.

(2) De-centralization

De-centralization of administrative control from higher level governments to lower level governments is another feature of the reform. It is believed that lower level governments are able to respond to changes more effectively than higher levels since they have superior information.

Accompanying the administrative de-centralization in the governmental organs, the split of administrative control and enterprise management in state-owned enterprises was implemented.

(3) Commitment to Socialism

Another distinct feature of the reform is the commitment to the socialist system.

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SEZ is a compromise solution to the problem of introducing foreign capital, permitting foreign capitalist practices in China and protecting domestic industries. Following the establishment of Shekou Industrial Park as a testing point in January 1979, five other SEZ (Shenzhen, Zhuhai, Xiamen, Shantou and Hainan) were later set up. The spread of SEZ reflected central government's idea of trial, spread and trial again.

An discussion of SEZ can be found in G. T. Crane, The Political Economy of China's Special Economic Zones (N.Y.: M. E. Sharpe, Inc., 1990) and K. Fukasaku, D. Wall, & M. Wu, China's Long March to an Open Economy (Paris: OECD, 1994) at 42.

73 Quan Ming Suo You Zhi Qi Ye.
That is, the state-owned enterprises. Socialist theory on the state is that the state represents all the people in the country. Property owned by the state is the property owned by all the people in the country.
and perseverance with socialist theory. It is clearly stated in China's Constitution that China is currently at the primary stage of socialism and concentrates on building socialism with Chinese characteristics. Correspondingly, the Chinese government emphasizes the dominant position of the publicly owned economy (i.e. state owned and collectively owned economy) within the national economy.

One of the functions of the CCL, therefore, is to provide a legal basis for incorporating state-owned enterprises. It is recognized under the CCL that the object of CCL is to “maintain the social economic order and promote the socialist market economy.” This policy goal is reflected in the corporate ownership structure in China where state/public ownership plays a dominant role in Chinese corporations.

3.2 The Context of Ideological Transformation

China is now at a crossroad, confronting conflicting ideologies in the process of building a socialist market economy. Struggling with its own faith, a state-controlled economy, and pressure from the global environment to move toward a more free

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74 Supra note 66 (1993 China's Constitution).
"...Our country is in the primary stage of socialism. The basic task before the nation is the concentration of efforts of socialist modernization construction in accordance with the theory of building socialism with Chinese characteristics..."

75 Article 7 of 1993 China's Constitution provides that the state-owned economy, i.e. the socialist economy with ownership by the people as a whole, is the leading force in the national economy. The state will ensure the consolidation and development to the state-owned economy.

76 Considering that most of the state-owned enterprises are losing money but possess major state assets, one of the reforming schemes is to incorporate state-owned enterprises and push them to market so as to increase their efficiency and rationally utilize resources. Section 3 of Chapter 2 of the CCL provides for the incorporation and the organization of wholly state-owned corporations.

77 Article 1 of CCL. (emphasis added)

78 Article 15 of 1993 China's Constitution provides that the state practices socialist market economy.
economy; facing the conflicting reality of socialist theory regarding all people's prosperity and the nation's present under-developed productivity, China has gradually established its own theory - socialism with Chinese characteristics\textsuperscript{79} - which I will call "pragmatism", to resolve the ideological conflicts. Pragmatism allows co-existence of the conflicting ideologies and permits China to build its market economy without relinquishing the belief of Marxism. It permits Chinese people to borrow western corporate practices and experiences without worrying about conflicting ideologies. Such co-existence and resolution of conflicts have been deemed a further development of Marxism taking into account Chinese reality.\textsuperscript{80}

Pragmatism recognizes that China is currently at the primary stage of socialism. Socialism is the primary stage of communism.\textsuperscript{81} Although the objectives of both socialism and communism are to build a prosperous, democratic and strong society, the primary stage of socialism is under-developed. This explains why currently China's economy lags behind that of developed countries. The task of a country at the primary stage of socialism is to develop national productivity and the economy. Planned economies and market economies, in spite of their conflicts, both can be adopted so long as they are favorable to promoting the growth of the productive forces in a socialist society, increasing the overall strength of the socialist state and improving people's living

\textsuperscript{79} Supra note 66 (1993 China's Constitution).

\textsuperscript{80} Z. M. Jiang, "Upholding the Great Banner of Deng Xiaoping's Theory on Building Socialism with Chinese Characteristics, Seizing Current Opportunities and Making Bold Explorations to Advance Our Cause to the 21st Century," 1997 (August 25 - 31) Beijing Review. This was a speech delivered by Jiang, Zemin, general secretary of the Chinese Communist Party on May 29, 1997 at the graduation ceremony of an advanced study course for provincial- and ministerial-level cadres at the Central Party School.

\textsuperscript{81} "Brief Introduction to Some of Deng's Speech", 1993 (Nov. 22 -28) Beijing Review at 33.
standards. As for private economy, it is a supplement to socialist public economy. Practically, as reform of state-owned enterprises has resulted in the laying off of a large number of employees, job-creating private businesses have become a bulwark against mass unemployment.

Responding to the ideological transformation, Chinese lawmakers meld the organizational structure of western private business and corporate management experiences into Chinese corporations in the context of a public economy and a socialist regime, notwithstanding that western corporate experiences are deeply rooted in private property rights. Particularly in the area of corporate internal control, the practices of CCL reflect the merge between the traditional socialistic model of enterprise management and

With the reinstatement of Deng Xiaoping as a Chinese Communist leader in 1978, he and his supporters initiated reforms and opened China to the outside world and tried to integrate the Chinese economy with the world economy.

See also "Decision of the Communist Party of China Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economic Structure" (adopted on November 14, 1993 by the Third Plenary Session of the 14th Central Committee of the Chinese Communist Party) 12 at 13.


84 Article 11 of 1993 China's Constitution. This article was added to the amendment to Constitution of the People's Republic of China (adopted at the First Session of the Seventh National People's Congress and promulgated for implementation by the Proclamation of the National People's Congress on April 12, 1988).
Recognizing the status of private companies is a breakthrough given that following the 1956 socialist transformation program, there was no private companies in mainland China.

85 It should be clarified that although China adopts private economy, public ownership (a concept opposed to private economy) is the mainstay of national economy.
"... it is necessary to uphold the principle of taking the publicly owned sector as the mainstay, while striving for a simultaneous development of all economic sectors, ...
See Z. M. Jiang, "Decision of the Communist Party of China Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economic Structure" (adopted on November 14, 1993
modern corporate governance principles in western countries.

3.3 The History of China's Corporate Laws: An Overview

Development of China's Corporate Laws lags behind its counterparts in the western world mainly because China lacks a free market and the corresponding economic and political circumstances for developing private business corporations. The adoption of laws relating to foreign investment corporations at the end of the 1970s, in the 1980s and 1990s and the first national corporation law in 1993 reflect a changing investment environment in China and Chinese law's positive response to its transitional economy.

The first company law in China was passed in 1904 during China's Qing Dynasty.\textsuperscript{86} This company law was drafted using Britain's 1856 Joint Stock Companies Act and 1862 Companies Act and Japan's 1899 Commercial Law Code as its principal models. In 1914, the government of the Republic of China adopted Companies Regulations based on Qing Dynasty's company law. In 1929, the government of the Republic of China promulgated a new company law that has a great influence in today's company law in the Taiwan area.\textsuperscript{87}

After the establishment of the People's Republic of China, the PRC under the leadership of the Chinese Communist Party abolished all laws and regulations adopted by the Republic of China including the company law. During the period of transition to


In China, it appears that development of law always lags behind that of business. For instance, joint stock enterprises appeared first with laws to regulate them appearing later.

\textsuperscript{87} For detail, refer to \textit{Ibid.} at 15; and
socialism (1949 to 1956), in order to regulate private companies established under the old legal system, *Interim Regulations on Private Enterprises* and *Implementing Rules on Interim Regulations on Private Enterprises* were adopted in 1950 and 1951 respectively. Adoption of the two interim regulations guaranteed at least the possibility of the existence of private companies in China during this period. Further encroachment upon private companies by the state appeared in the 1954 *Interim Regulations on Joint Operation of Public and Private Industrial Enterprises*. By involving state ownership in private companies, the state gradually controlled the operations of private companies. By the year 1956, all private companies were transformed into state or collective owned entities.

In 1979, with the implementation of the central government's "open-door" policy, China began attracting foreign capital. In order to assure the security of foreign capital and enhance foreign investors' confidence in the Chinese market, a series of laws specially governing foreign investment vehicles (that is, FIEs Laws) were promulgated. Advanced technology, management and awareness of the growing market shares of the foreign companies spurred Chinese domestic enterprises to reform their management

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88 Si Ying Qi Ye Zan Xing Tiao Li.

89 Si Ying Qi Ye Zan Xing Tiao Li Shi Shi Ban Fa. The *Interim Regulations on Private Enterprises*, provided for five forms of companies; i.e. unlimited company (Wu Xian Gong Si); limited company (You Xian Gong Si); Kommanditgesellschaft (German language) (Liang He Gong Si), which refers to a company in which some shareholders are subject to unlimited liability which others enjoy limited liability in terms of debts of the company. This form of enterprise is similar to Canadian limited partnerships. The form of company limited by shares (gu fen gong si) and KGaA (Kommanditgesellschaft auf aktien (Germany language) (Gu Fen Lian He Gong Si) which combines features of a company limited by shares and a Kommanditgesellschaft. It is like a joint-stock limited partnership.

90 Gong Si He Ying Gong Ye Qi Ye Zan Xing Tiao Li.

91 For detail, refer to *Supra* note 86 at 16; and *Supra* note 87 (Fan & Jiang) at 89.

92 See *supra* note 28.
model in order for survival. In the meantime, the government realized that a healthy competition environment would benefit the country's economic development. State-owned enterprises should not be the only form of business organization in the market. The year 1988 witnessed the adoption of two business association laws: *Law of the People's Republic of China on Public-owned Industrial Enterprises* and *Interim Regulations on Private Enterprises of the People's Republic of China.* During the course of diversifying ownership, joint stock companies appeared. In 1990, the Shanghai Stock Exchange was opened. A year later, the Shenzhen Stock Exchange was established.

The whole process of drafting the CCL took Chinese lawmakers ten years. The State Economic Committee and the State System Reforming Committee began the drafting work in 1983. Four years later, the two Committees gave up the idea of drafting corporation law given that most companies at that time were state owned enterprises. In 1986, the two Committees began drafting two Standard Opinions which were finalized in

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93 Zhong Hua Ren Min Gong He Guo Quan Min Suo You Zhi Gong Ye Qi Ye Fa (adopted at the First Session of the Seventh National People's Congress, and promulgated by Order No. 3 of the Chairman of the People's Republic of China on and effective from August 1, 1988.)

94 Zhong Hua Ren Min Gong He Guo Si Ying Qi Ye Zan Xing Tiao Li (adopted by the Seventh Regular Meeting of the State Council on June 3, 1988, promulgated by the State Council on June 25, 1988 on and effective from June 1, 1988.)

95 However, the securities law in China was not developed at that time. It was eight years after opening of the Shanghai stock exchange that the first national securities law was issued. *Securities Law of the People's Republic of China* (adopted at the Sixth Meeting of Standing Committee of the National People's Congress on December 29, 1998 and effective on July 1, 1999).

96 Under China's legal system, according to the Constitution of the People's Republic of China, the National People's Congress (NPC) is the supreme legislative organ in the PRC. It has the power to enact and amend basic laws and laws in association with the organization of state organs. The NPC can also amend the Constitution through a special procedure. Generally speaking, in addition to the NPC, NPC Standing Committee, the State Council, the people's congresses at provincial level and the people's congresses of national autonomous regions all have certain authority to make regulations. The NPC Standing Committee may enact and amend all laws except those which may only be enacted by the NPC, provided that the supplements and amendments do not contravene the basic principles of the original
1992: Standard Opinions on Limited Liability Company\textsuperscript{97} and Standard Opinions on Joint Stock Company with Limited Liability (Standard Opinions).\textsuperscript{98} On the basis of local experience in formulating corporate regulations, the Standard Opinions nationalized corporate provisions in China.\textsuperscript{99} With the benefit of some experience with joint stock corporations in China and with Chinese stock markets, lawmakers assimilated certain western corporate management practices and officially introduced a number of fundamental concepts of a corporation (like share, shareholder, listed corporation and so on) into China. The two Standard Opinions became the forerunner of the CCL. Based

\textsuperscript{97} You Xian Ze Ren Gong Si Gui Fan Yi Jian

\textsuperscript{98} Gu Fen You Xian Gong Si Gui Fan Yi Jian

\textsuperscript{99} Like economic reform in China which originated locally and experimentally, the framework of Standard Opinions could be traced to Interim Provisions of Shenzhen Municipality on Corporations Limited by Shares.


It should be noted that on May 15, 1992, the Economic System Restructuring Commission, the State Planning Commission, the Ministry Finance, the People's Republic of China and the State Council Production Office issued Share System Experimental Procedures of the People's Republic of China.

In order to clear out doubts on the status of Standards Opinions (some people did not think they had the status of a "law" or "regulation"), the State Council issued a notice (State Council Office Notice Concerning Implementation of the Standard Opinions (May 15, 1993) (Guo Ban Fa, No. 27, 1993)) to clarify that the Standard Opinions had the effect of ministry-level law and regulation.
upon the experience of these shareholding companies, CCL was finally issued in 1993.\textsuperscript{100}

Given China's transitional economy, China's Corporate Laws are still in the stage of transitional development. The co-existence of FIEs Laws and the CCL is an example. CCL now applies to foreign investment enterprises just as FIEs Laws do. But where FIEs Laws and CCL have conflicting provisions, provisions under the FIEs Laws prevail.\textsuperscript{101}

Summary

It is observed that the Canadian economy is developing toward a digital economy\textsuperscript{102} and integrating with the economy of the US and ultimately, potentially, with South America. In the meantime, China is diversifying enterprise ownership structures from pure state ownership to non-state and private ownership. Such different development trends can be linked to the different political regimes and economic development models of the two countries. Economic development in Canada requires a well-designed business vehicle that permits efficiency through a combination of predictability and flexibility, with adequate investor protection. The CBCA, in response to this requirement, facilitates efficient management of business and requires management accountability to investing property owners, and it has been significantly influenced by American corporate law. Maintaining a socialist regime in China, especially under the

\textsuperscript{100} For a more detailed description, see Supra note 62 at 464; and G. L. Zhang, & M. Zhou, eds., Explaining on Corporate Law (China: Publishing House of People's Court. 1993) (Chinese version).

The process of drafting China's Corporation Law reflects that in the area of corporate law, the Chinese approach is to formulate law according to what is happening or trials in practice.

\textsuperscript{101} Article 18 of CCL.

\textsuperscript{102} Supra note 32.
pressure of the collapse of the SU and socialist eastern European countries, requires the abandonment of long-standing doctrines mandating pure state ownership and the creation of incentives through property ownership. China's Corporate Laws, in response to these requirements, establish an organization structure of business corporations that draws upon corporate experiences from the western world. By so doing, it is hoped that western-style business corporation structures and western corporate experiences can increase the efficiency of Chinese corporations and help attract foreign capital to meet the needs of Chinese economic development.
4.1 Shareholders - Control through Ownership

The brief historical outline in Chapters 2 and 3 of Canadian and Chinese economic development and their relationship to the development of business corporations in both countries suggests that principally, the corporate form was devised and developed to satisfy the need for raising equity capital to facilitate the operation of business. It is safe to say that from the outset, corporations have been connected with capital. Investors are capitalists. The rights and obligations of investors in connection with the corporations in which they invest are property rights and obligations.

By transferring property to the corporation and subscribing for shares, investors become the owners of shares of the corporation. Shares represent the status, interest and right that the investors have in the corporation and the liability that the investors have to bear for the corporation. While holding the shares of the corporation, investors are...

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103 See also J. B. Baskin & P. J. Miranti, *A History of Corporate Finance* (Cambridge & New York: Cambridge University Press, 1997). In this book, Baskin and Miranti recognized how the early preference for debt financing gradually yielded to equity financing. It should be noted, however, that Baskin and Miranti linked the rise of equity more to the development of markets for trading equity than to the evolution of the corporate form.

104 "A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place and of interest in the second..." See Farwell J. in *Borland's Trustee v. Steel*, [1901] 1 Ch.279 at 288. Cited by L.C.B. Gower, see supra note 34 at 398. With regard to the liability of shareholders, it is noted that in the early 20th century, issued share capital could consist partly of paid up capital (representing the total of the payments made in respect of the issued shares) and partly of uncalled capital (representing the balance, if any, between the amount already paid and the total nominal or par value of the issued shares). See supra note 34 at 217-218. Under today's CBCA, a share may not be issued until the consideration for the share is fully paid in money or in property or past services. See CBCA s.25 (3), (4) and (5). The principal reason underlying fully paid shares provided by the Dickerson Report is protection of shareholders since shareholders owning partly-paid shares can become liable to make further payments when "called" or suffer forfeiture of their shares. "By issuing partly-paid shares, a corporation could therefore avoid securities commission..."
shareholders of the corporation. According to the shares they possess, the corporate law of the relevant jurisdiction, and agreements they enter into, shareholders exercise their rights (or may not exercise their rights) and shoulder limited business risks.

Since shares are so closely connected with shareholders' status in a corporation, before discussing shareholders' controlling/influencing power in Canadian and Chinese corporate decision-making, it seems necessary to examine share structures under the CBCA, CCL and in China's business reality. The following comparative examination of share structures in Canada and China reveals that China on the one hand adopts corporate share structures similar to those found in capitalist countries yet, on the other hand, remains committed to a socialist regime by ensuring government monitoring of the amount of private capital on the Chinese equity market.

4.1.1 Share Structures: Registered Shares and Bearer Shares

...
Shares of a corporation under the CBCA must be in registered form.\textsuperscript{106} Shares of a corporation under CCL may be in registered or in bearer form.\textsuperscript{107} Further, CCL provides that shares issued by a corporation to promoters, state authorized investment institutions or legal persons\textsuperscript{108} should be in registered form; while shares issued to the public may be either registered shares or bearer shares.\textsuperscript{109}

There are differences between registered shares and bearer shares in terms of shareholders' power to vote and transfer shares. As to voting, a shareholder with registered voting shares has a right to vote at shareholders' meetings without any further compliance with other legal procedures (except when voting by proxy). It is otherwise, however, in the case of holders of shares in bearer form. In order to qualify as a voting shareholder, a holder of bearer shares, according to CCL, has to deposit his/her shares with the corporation for the period commencing five days prior to the shareholders' meeting until the end of that meeting.\textsuperscript{110}

In reality, many holders of bearer shares in China (most of whom are individual investors) do not deposit their shares with the corporation in order to exercise their voting

\textsuperscript{106}CBCA s.24 (1).

\textsuperscript{107}Article 133 of CCL.

\textsuperscript{108}According to Article 36 of 1986 \textit{General Principles of Civil Law of the People's Republic of China} (China's Civil Law), a legal person is "an organization that has capacity for civil rights and capacity for civil conduct and independently enjoys civil rights and assumes civil obligations in accordance with the law." Article 37 of China's Civil Law further provides conditions for qualifying a legal person: (1) establishment in accordance with the law; (2) possession of the necessary property or funds; (3) possession of its own name, organization and premises; and (4) ability to independently bear civil liability. Chapter 3 of China's Civil Law categorizes legal persons into two classes: first are enterprise legal persons (i.e. legal persons with the purpose of making profit); second, are official organs, institutions and social organizations (i.e. legal persons that do not have as their objective the making of a profit). The term "legal person" in China's Corporate Laws refers to enterprise legal persons.

\textsuperscript{109}\textit{Supra} note 107.

\textsuperscript{110}Article 105 of CCL.
rights mainly because of a lack of interest in voting. Therefore, they leave the decision-making power to the registered shareholders. If the registered shareholders are also uninterested in corporate matters (as they may be in the case of large widely-held public corporations), the corporate decision power will be left with the management through the proxy mechanism. As a result, the structure of bearer shares in modern corporations will more easily lead to the phenomenon of a split between ownership and control. The examination of individual shareholders' status in Chinese corporations in 4.1.4 B(5) is a typical example of such split and its relationship with the bearer shares structure.

As to share transfer, the mobility function of bearer shares is superior to that of registered shares. However, bearer shares are less secure than registered shares. In terms of mobility, once a holder of bearer shares delivers his/her share certificate to a transferee (either directly or through a broker), the share transfer becomes effective.112 Transfer of registered shares under the CCL requires endorsement and registration of the transfer.113 Under the CBCA, registration of the transfer of registered shares is also required.114 Because of the mobile nature of bearer shares, bearer shares are less secure than registered shares. Physical possession of share certificates does not matter to registered shareholders but does matter to holders of bearer shares. In China, if a holder of bearer shares loses

111 In China, the management of a corporation usually has the contact details of the registered shareholders but not of the bearer shareholders. Therefore, management is able to solicit management proxies from the registered shareholders. With respect to holders of bearer shares, public announcement (through newspapers) may be employed for the solicitation.

112 Article 146 of CCL.

113 Article 145 of CCL.

114 CBCA s.76 (1). However, CBCA s.48 (3) does also provide that, except where its transfer is restricted and noted on a security in accordance with relevant statutory provisions (e.g. CBCA s.49(8)), a security (including a share certificate) is a negotiable instrument. Part VII of the CBCA further provides provisions on constrained share corporations.
his/her share certificate, in order to prevent any property loss, a legal remedy provided by
Chinese civil procedure law must be sought for a declaration declaring that the share
certificate is null and void.\textsuperscript{115}

The long-term peaceful social environment and the absence of business practices
and statutory traditions favoring bearer shares might account for the lack of a bearer share
structure under the CBCA. Unlike Canada, China has suffered from foreign invasion and
domestic wars during the 19\textsuperscript{th} and 20\textsuperscript{th} centuries.\textsuperscript{116} Bearer shares were first provided for
in China in the early 20\textsuperscript{th} century. The turbulent social circumstances at that time help
explain the preference for a bearer shares structure which offered holders mobility and
anonymity. The existence of bearer shares in China also indicates that the Chinese
government either does not realize that tax evasion may arise when bearer securities are
permitted or is not concerned about any such potential tax evasion. A corporation does
not have a list of holders of bearer shares. Holders of bearer shares in China engage in
share transactions through brokers. Unless China's tax authorities want to trace the share
transactions including receipts of dividends of holders of bearer shares through depository

\textsuperscript{115} See Chapter 18 of \textit{Civil Procedure Law of the People's Republic of China} (adopted on the Fourth
Meeting of the Seventh National People's Congress on April 9, 1991 and promulgated by Order No.16 of
the President of the People's Republic of China on April 9, 1991 and effective as of April 9, 1991).
An English translation of the \textit{Civil Procedure Law of the People's Republic of China} is available online:
University of Maryland - ChinaLaw Website \texttt{<http://www.qis.net/chinalaw/lawtranI.htm>}(date accessed:
June 30, 1999).

\textsuperscript{116} For instance, The Opium War (1839 - 1842); Taiping Rebellion (1851 - 1864); The Hundred Days' Reform (June 11, 1898 - September 21, 1898); Republican Revolution of 1911; Anti-Japanese War (1937
- 1945); Civil War between Nationalism and Communism (1920s - 1940s).
For a detailed illustration of Chinese history, See Sondra Hamilton, "Windows on Chinese History" Online:
For thousands of years, China was ruled by dynasty after dynasty. In addition to those internal struggles
and riots accompanying the change of dynasty, foreign invaders including Russia, Japan and Britain
controlled significant parts of the country. China finally became a republic country in 1912. But after
that, China was involved in World War II, engaged in territorial disputes with its neighboring countries,
and underwent civil war.
institutions or unless holders of bearer shares voluntarily report their share transactions to the tax authorities, tax is more easily evaded through the structure of bearer shares than through the structure of registered shares. The absence of bearer shares under Canadian law may thus reflect, in part, the Canadian government's recognition of, and concern over, tax evasion problems in connection with the structure of bearer shares.

With regard to the special requirement for Chinese promoters, state-authorized investment institutions and legal persons to hold registered shares, this may be seen as a reflection of China's socialist ideology: interests of the state or the collective are considered more important than the interests of individuals. Therefore, it is thought that shares held by the state, institutions or legal persons should be more secure than shares held by individuals under Chinese law.

4.1.2 Share Structures in Reality: A Unique Classification of Shares in China

The classification of registered shares and bearer shares is provided by the CCL. In addition to this simple share classification, another more complex classification of shares has been adopted by the Shanghai Stock Exchange, the Shenzhen Stock Exchange, and the business communities in China. This latter classification appears to have more significance in determining Chinese people's right to purchase shares and seems to have more "Chinese characteristics".

Chinese share classification connects share structure with the nationalities of the investors and the jurisdiction in which a corporation is listed, if its shares are listed on a

117 The Shanghai Stock Exchange and Shenzhen Stock Exchange are the only national stock exchanges in China.
foreign exchange. Shares are categorized into A Shares, B Shares, Red Chip Shares, L Shares and N Shares.

A Shares refer to shares traded on the Shanghai and Shenzhen Stock Exchanges, and represent ordinary share ownership in a Chinese corporation. They are available exclusively to investors with Chinese citizenship, although not to residents of Hong Kong. B Shares have exactly the same beneficial ownership rights as do A Shares, but can be purchased (and held) only by investors with foreign citizenship. B Shares are quoted in U.S. dollar amounts on both the Shanghai and Shenzhen Stock Exchanges. Red Chip Shares are listed on the Stock Exchange of Hong Kong. These shares are issued by corporations that are controlled by the Chinese government but that usually have been incorporated in Hong Kong, rather than in mainland China. L Shares are shares of corporations incorporated in mainland China that have chosen to be listed on the London Stock Exchange. N Shares are shares of corporations incorporated in mainland China that have chosen to list on the New York Stock Exchange.118 B Shares, Red Chip Shares, L Shares and N Shares are not tradable with A Shares.119

The relationship between share structure, investor's nationality and the jurisdiction in which a corporation is listed (if its shares are listed on a foreign exchange), appears to reflect the fact China is subject to foreign exchange control. Foreign currency is not negotiable in China. China's currency - Renminbi - and foreign currency are not freely convertible in China. Moreover, the isolation between A Shares and the other categories


119 B Shares, L Shares and N Shares are designed to attract foreign capital to invest in Chinese corporations, while Red Chip Shares play the role of attracting capital from Hong Kong.
of shares derives from the government's reluctance to allow foreign capital to control the Chinese equity market.

The capital of those corporations listed on the Shanghai and Shenzhen Stock Exchanges (i.e. corporations with A Shares structure), is further categorized into State Shares (shares held by the state), Legal Person Shares (shares held by a legal person established in China), Employee Shares (shares held by employees of the corporation) and Social Public Shares (or Individual Shares, i.e. shares held by individual investors other than the employees of the corporation).

The classification of shares in China in accordance with investors' nationality (Chinese citizen or foreign citizen) directly reflects the government's cautious attitude toward the privatization process and its concerns over foreign capital in the Chinese market. The further classification of A Shares depending upon whether the holders are the state, legal entities, or individuals indicates the government's anxiety about the relative proportion of capital controlled by the public and private sectors in the market. One of the features of socialism is that public capital (as opposed to private capital) should always be in the majority position.

Employing this complex classification method enables

120 Supra note 108.

121 Employee Shares are issued through internal offerings and sold at a discount or may take the form of bonus shares without any charge to the employees. They are not tradable in the secondary market.

122 Usually state shares and legal person shares constitute the majority of the A Shares market. See Fang Liufang, "China's Corporatization Experiment" (1995) 5 Duke J. Comp & Int'l L. 149 at 200 - 212.


"The socialist market economic structure is linked with the basic system of socialism. The establishment of this structure aims at enabling the market to play the fundamental role in resource allocation under macro-economic control by the state. To turn this goal into reality, it is necessary to uphold the principle
Chinese authorities to maintain a very clear view of the status of public ownership in China's equity markets.

Thus, though CCL's provisions regarding share structures more or less adopt western corporate experiences, the classification of share structures in China's business reality moves away from capitalist countries' corporate practices.

4.1.3 Corporate Ownership Structures in Canada and China

By subscribing for shares, investors become the owners of shares of the corporation. The power of the shareholders to exert influence upon or control the corporation arises from shareholders ownership of shares. In order to understand thoroughly the shareholder's role in the corporation, and especially shareholders' statutory rights provided by the CBCA and CCL, one has to examine current corporate ownership structures in Canada and China. The following examination of corporate ownership structures in Canada and China indicates both common features and differences. Both Canadian and Chinese corporate markets are dominated by closely-held corporations. Both corporate markets have high ownership concentration. Moreover, Canada has high overlapping ownership of corporations and that, in turn, results in high overlapping directorships. In terms of employee ownership, though it is far from developed, China seems to prefer to diversify state ownership through employee shares.

A Common Features: Dominance of Closely-held Corporations and High Ownership

of taking the publicly owned sector as the mainstay, while striving for a simultaneous development of all economic sectors, ..." (emphasis added).
Concentration in Canadian and Chinese Corporate Market

In the Canadian corporate market, the closely held corporation is the norm.\textsuperscript{124} It is the same in the Chinese market.\textsuperscript{125} Though publicly held corporations may have certain economic significance in both Canadian and Chinese national economies, the quantity of closely held corporations no doubt outweighs that of publicly held corporations.

It is also evident that one observes in both Canada and China the phenomenon of high corporate ownership concentration in public corporations. But the phenomenon arises from different causes in the two countries.

High ownership concentration is a distinctive feature of Canadian corporations.\textsuperscript{126} An examination of 766 Canadian corporations conducted by Rao and Lee-Sing in 1996\textsuperscript{127} demonstrated that 55.5 per cent of Canadian corporations are legally controlled (i.e. one shareholder or a small group of shareholders owns, directly or indirectly, more than 50 per cent of the voting shares of a corporation); 21.4 per cent are effectively controlled (i.e.

\textsuperscript{124} R. Daniels & J. MacIntosh, "Toward A Distinctive Canadian Corporate Law Regime" (1991) 29 Osgoode Hall L. J. 863 at 884.

\textsuperscript{125} According to the statistics of Shanghai Administration of Industry and Commerce, as of December 31, 1998, China had 1,189,684 closely-held corporations (i.e. limited liability companies) and 235,073 publicly-held corporations (i.e. joint stock companies). Data collected by Mr. Zhao, Linyu from Shanghai Administration of Industry and Commerce in May 1999.

\textsuperscript{126} Supra note 124 at 884.

Only 14% of the corporations included in the Toronto Stock Exchange 300 index were widely held in 1990. Of the remainder, 60.3% were owned by a single shareholder with legal control (greater than 50% of voting shares), 25.4% by one shareholder with effective control (20 to 49.9% of voting shares) or by two or three shareholders having the ability to combine and establish legal or effective control.

A typical example in New Brunswick is the empire of K. C. Irving which has around 400 companies and generates about 25% of New Brunswick's gross domestic product.


one shareholder or a small group of shareholders owns, directly or indirectly, 20 per cent to 49.9 per cent of the voting shares; and only 23.1 per cent are widely controlled (i.e. no shareholder or group of related shareholders owns, directly or indirectly, more than 20 per cent of the voting shares).

The existence of many individual or family controlled corporations in Canada has been noted by many commentators. Some scholars have argued that endowment effects might aggravate this phenomenon. The endowment effect may make a single controlling shareholder or related controlling shareholders more reluctant to part with control, which in turn, increases the premium required to effect a transfer. Thus, the endowment effect may make the single controlling shareholder or related controlling shareholders decide to retain control of a corporation even though it appears economically irrational to do so.

Canadian publicly held corporations also exhibit a high degree of ownership concentration. A number of facts may account for the high ownership concentration

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128 R.J. Daniels & P. Halpern, “Too Close for Comfort: The Role of the Closely Held Public Corporation in the Canadian Economy and The Implications for Public Policy” (1996) 26 Can. Bus. L. J. 11 at 20. The endowment effect refers to the phenomenon whereby an owner of property is reluctant to sell for the price at which she or he was prepared to buy.

129 Ibid.

130 Ibid. While diverting corporate resources and corporate wealth enhancement are both activities that could increase the wealth of controlling shareholders, they may rationally refrain from doing either since the expended effort may outweigh the realized benefits.

131 See C.W. Roth, “Concentration of Ownership and the Composition of the Board: An Examination of Canadian Publicly-listed Corporations” (1996) 26 Can. Bus. L. J. 226 at 228 and 240. In Roth’s study of 568 sample corporations, he found: 50% of the corporations are under the ownership of one or a small group of shareholders, who hold, directly or indirectly, 50% or more of the voting shares; 26.7% are controlled by one or a small group of shareholders owning, directly or indirectly, 20% - 49.9% of the voting shares; and only 22.2% are widely-held. Of the 568 corporations in the sample, 503 were listed on the Toronto Stock Exchange, 29 were listed on the Montreal Stock Exchange, 14 were listed on the Alberta Stock Exchange, and the remaining included 10 over-the-counter stock, 9 listed on the Vancouver Stock Exchange and 2 listed on the American Stock Exchange.
observed in Canadian corporations. The emergence of institutional shareholders as
controlling shareholders in publicly-held corporations is one explanation. Rao and Lee-
Sing’s research shows that institutional owners control about 38 per cent of the dollar
value of shares in Canada. Thus the dramatic increase of total equity holdings by banks,
life insurance companies, trusteeed pension plans, trust and mortgage loan corporations and
investment funds over the past two decades in Canada, has resulted in such institutional
investors becoming controlling shareholders in large public corporations. Second, as
mentioned in chapter 2 above, the Canadian economy is resource based. A low value
added resource-based economy may require a high degree of consistent corporate policy
and management to retain the vulnerable value of the corporations. The concentration

132 Supra note 127 at 9.

Bus. L. J. 145 at 147.
"Total equity holding of banks, life insurance companies, trusteeed pension plans, trust and mortgage loan
corporations, and investment funds grew (in constant 1986 dollars) from $4.7 billion in 1969 to about $85
billion in 1990. There has been significant growth in equity holdings in some sectors even since 1990.
For example, between 1990 and 1993 the constant dollar value of equity holdings of investment funds
more than doubled. More generally, the constant dollar value of institutional equity holdings has
operated over the past two decades...
Life insurance companies held only 2.58% of their portfolios in equities in 1963. Although there have
been ups and downs between 1963 and 1992, the proportion of the portfolio devoted to equities hit a high
of 19.7% in the bull market of 1992... The proportion of the aggregate portfolio of trusteeed pension plans
held in Canadian equities increased from 17.9% in 1969 to 23.14% in 1990... For trust and mortgage and
loan corporations, equity holdings as a percentage of the total portfolio increased from 2% in 1969 to just
over 2.5% in 1994... In 1969, 1.59% of the aggregate bank portfolio was held in equities, and in 1994, 1.32%.
However, bank equity holdings went as high as 5.18% in 1980. Since 1982 there has been very
little change."

134 In Canada, the assets of pension and mutual funds have increased more than 35 times in value since
the mid-70s. Pension funds (like the $49-billion Caisse de Depot, the $53-billion Ontario Teachers’
Pension Plan Board, and the $30-billion Ontario Municipal Employees’ Retirement Fund), and mutual
funds are the biggest equity holders.
See TSE News Release, "'How and Why Corporate Governance is Changing Worldwide' - Toronto Stock
Exchange President Rowland Fleming remarks to the International Corporate Governance Conference in
San Francisco - July 9,1998" TSE Online:
23, 1999).

135 Unlike other corporations, for instance, small corporations providing services, may change corporate
policy very often in order to keep pace with constantly changing markets or to look for high value added
of ownership within a corporation is more likely to ensure a relatively consistent corporate policy and management. Third, Canada may have a relatively low-cost debt system.\(^{136}\) If so, Canadian controlling shareholders would be able to access capital without the sale of equity.\(^{137}\) Fourth, the structure of non-voting shares or restricted voting shares allowable under the CBCA\(^{138}\) and existing shareholders' pre-emptive rights to purchase equity\(^{139}\) also may contribute to the high ownership concentration in Canada. Fifth, in a country with vast geographical space and limited population, a political need for establishing an integrated national economy may invite a high ownership concentration in the corporation.\(^{140}\)

In the case of China, according to the statistics of the Shanghai Administration of Industry and Commerce, as of December 31, 1998, China has 1,189,684 closely-held corporations and 235,073 publicly-held corporations. In Shanghai, as of December 31, 1998, there are 12,819 closely-held corporations and 1,663 publicly-held corporations.\(^{141}\)

\(\ldots\)

\(\ldots\)

\(\ldots\)

\(^{136}\) *Supra* note 128.

Professor Christopher C. Nicholls of Dalhousie Law School has suggested, this is a controversial point and, ultimately, one that can only be resolved through empirical research. The basic idea is that the concentrated Canadian banking system facilitates monitoring of business, and therefore, by reducing default risk, lowers the overall cost of debt finance. If this conclusion is correct, we would observe differences between the capital structures of Canadian and US corporations. Specifically, Canadian corporations would have more debt on their balance sheets than otherwise comparable US corporations.

\(^{137}\) *Ibid.* at 38.

\(^{138}\) CBCA s.24.

\(^{139}\) CBCA s.28(1). Although pre-emptive rights are not obligation, they may be adopted by CBCA corporations.

\(^{140}\) *Supra* note 128 at 33.

\(^{141}\) Data collected by Mr. Zhao, Linyu from Shanghai Administration of Industry and Commerce in May 1999.
High ownership concentration exists in both closely-held corporations and publicly held corporations.¹⁴²

Unlike Canadian corporations, Chinese corporations have a high state/public ownership concentration.¹⁴³ Though there are few family controlled corporations in China, there are many wholly state-owned enterprises. One of the purposes of adopting CCL was to "corporatize" state-owned enterprises¹⁴⁴ and sell part of the shares of such state-owned corporations to their employees and/or the public with a view to increasing the efficiency of most loss-making state-owned enterprises.¹⁴⁵ With state/public ownership playing a predominant role in the Chinese economy,¹⁴⁶ it is not surprising to find high state/public ownership concentration.

Further, unlike in Canada, institutional shareholders in China play virtually no role in controlling corporations since investment banks, life insurance companies, pension funds and mutual funds are all institutions that are still new to the Chinese people. Moreover, some of these institutions operate in China in a way that is totally different from their counterparts in the western world.¹⁴⁷

¹⁴² More detailed information on ownership concentration is not available.

¹⁴³ State/public ownership, as opposed to private ownership, refers to state ownership and collective ownership.

¹⁴⁴ That is, turning state-owned enterprises into shareholding companies so as to diversify the ownership structure of the enterprises.


¹⁴⁶ See the chart - Structural Indicators on National Economic and Social Development - as shown in 4.1.4 B (5).

¹⁴⁷ As to institutional investors, professor Fang Liufang described institutional investors as trade unions, the Communist Youth League, or the Women's Federation with funds raised from its members, a conception totally different from Canadian commercial institutional investors. According to professor
Consider the example of pensions. The Chinese government is now trying to establish a multi-pillar pension system which, according to the State Council's 1995 *The Directive on Further Reform of the Enterprise Pension System*, involves funds contributed by the state, employers, and individuals\(^{148}\) to resolve the problem of offering pension benefits to Chinese employees left by years of a planned economy in China. The pension is managed by the social insurance departments of provincial governments and supervised by the Ministry of Labor and its delegated bureaus. The pension fund is now only investing in government bonds (rather than equities) in the Chinese capital markets. Accordingly, the composition and operation of pensions in China are totally different from those of Canadian pension funds which are more in the nature of private funds and private investments.

In addition to the facts of historical economic development as described in Chapter 3 above and the business reality in China as disclosed in 4.1.4 B (5) above, this country's socialist ideology also contributes to the phenomenon of high state/public ownership concentration because according to socialist theory, public economy (rather than private economy) should be in the dominant position in a socialist country. Moreover, competition with large companies from other countries in the global market is also a factor that contributes to a high state/public ownership concentration in China. The idea that

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\(^{148}\) Funds from employers and employees together constitute about 10-20 per cent of an employee's total wages. Of this 10 - 20 per cent, employees have to contribute about 2 - 5 per cent of their own wages. By the third quarter of 1995, about 87 million workers and 21 million retirees in China had participated in the pension scheme. J. Ma (World Bank), "China's Economic Reform in the 1990s" (January 1997) online: <http://members.aol.com/junmanew/chap1.htm> (date accessed: June 26, 1999).

See *supra* note 122 at 207.
Chinese corporations should be large in order to compete with other large foreign corporations coupled with the fact that the Chinese equity market is undeveloped so that the state is the major source of corporate equity capital results in high state/public ownership concentration in China.

Mixed-ownership corporations (that is, corporations with a high degree of state/public ownership and a low degree of private ownership) represent a compromise between socialism and a free economy. In the words of Dimock commenting on Canadian mixed-ownership corporations, such corporations represent a "compromise between \textit{laissez-faire} economics and socialism".\footnote{Dimock's wording, cited by S. Brooks, \textit{Who's in Charge? The Mixed Ownership Corporation in Canada} (Canada: The Institute for Research on Public Policy, 1987) at 11.} The CCL emerged from and reflects China's transitional economy - a socialist market economy which is based on a compromise between two conflicting concepts: market economics and socialist ideology. The partnership of public and private capital within a single business organization and the resulting, the struggle to achieve a balance between a corporation's social function and the profit-maximization goal affects the model of corporate control in China.

B Different Features: Overlapping Ownership in Canadian Corporate Market and Employee Ownership in Chinese Corporate Market

In addition to the common features of Canadian and Chinese corporate markets, (i.e. domination of closely-held corporations and high ownership concentration in public corporations), there are different characteristics between Canadian and Chinese corporate markets in terms of overlapping ownership and employee ownership.
The Canadian market is characterized by highly interconnected corporate relationships due to significant inter-corporate ownership patterns in Canada. This, in turn, leads to a high degree of overlapping directorships in Canada. Overlapping directorships raise issues regarding the accountability of corporate boards. This issue will be addressed in 4.2 below.

In terms of employee ownership, although the concept of employee share ownership plans originated in North America, Chinese reformers were attracted by this concept and believed it could offer hope of improved corporate performance. The Shanghai and Shenzhen Stock Exchanges require all listed corporations to disclose employee shares. The use of internal employee shares has become one of the measures for reforming and reorganizing state-owned corporations, since it allows corporations to borrow capital from their employees and is an incentive device for the corporations to enhance employees' commitment to their

150 Supra note 124 at 888. "Of the top one hundred most profitable companies in Canada in 1987, close to 45 per cent held 10 per cent or more of the voting shares of another company on the list.... 296 of 1023 directors held two or more appointments. 71.1 per cent of those [one hundred most profitable companies in Canada] board appointments were held by directors with only one appointment. 17.5 per cent by directors with two appointments, and 11.4 per cent by directors with the three or more appointments." See also, S. D. Berkowitz et al., Royal Commission on Corporate Concentration Study No.17: Enterprise Structure and Corporate Concentration (A Technical Report) (Ottawa: Minister of Supply and Services Canada, 1977) at 15; and J. C. Baillie, "Comments of a Business Lawyer on Rules Governing Boards of Canadian Public Corporations" (1996) 26 Can. Bus. L. J. 127 at 128.

151 The employee stock ownership plan concept was developed in the United States in the 1950s by lawyer and investment banker Louis Kelso, who argued that the capitalist system would be stronger if all workers, not just a few stockholders, could share in owning capital-producing assets. In 1973, Kelso convinced Senator Russell Long, chairman of the tax-writing Senate Finance Committee, that tax benefits for the employee stock ownership plan should be permitted and encouraged under employee benefit law. See: "A Short History of the ESOP" Online: The National Center for Employee Ownership <http://www.nceo.org/library/history.html> (date accessed: April 22, 1999).

152 Refer to supra note 121.

153 This is very common. Employee shares have not only been accessed by managers but also by other workers and staff.
But the development of employee ownership in China is far from mature compared with similar institutions in North America. Currently, in China employee share ownership plans are used mainly as a channel for corporations to raise capital since it is costly to borrow capital in Chinese capital markets. In North America, such plans are used, instead, for creating a work force of employee-owners; buying shares from departing shareholders of a closely-held corporation; creating an employee benefit plan; divesting or acquiring subsidiaries; buying back shares from the market; and as a takeover defense. In Canada, most provinces have promulgated legislation providing substantial tax credits for investment in employee stock. Associations have been established for

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154 Canadian statistics in respect of employee ownership are not available.

155 "A Brief Introduction to Employee Ownership" Online: The National Center for Employee Ownership <http://www.nceo.org/library/library.html> (date accessed: April 22, 1999). There are about 15,000 companies in the U.S. that share ownership broadly with employees. Over 10,000 of these are ESOPs (Employee Stock Ownership Plans).

156 Ibid.


researching employee share ownership in Canada.\textsuperscript{159} But nationally, there are no federal laws or regulations at the time of writing that specifically encourage the development of employee share ownership. Chinese authorities, however, recently have signaled the need for caution in further increasing employee share ownership since significant employee share ownership in a corporation means that if a corporation fails to survive, the employees might lose not only their jobs but also their savings.\textsuperscript{160}

4.1.4 Voting through Shares at Shareholders' Meetings: The Majority Rule

The above sections have presented comparative examinations of share structures and corporate ownership structures in Canada and China. Notwithstanding that shareholders' controlling influence power over corporate policy and management arises from their ownership of shares, it is through voting that shareholders exercise their rights and exert their power.

The right to vote is the most essential right by which shareholders participate in and control the corporation.\textsuperscript{161} The number of votes that a shareholder has is determined by the type and number of shares he/she holds. Through voting, shareholders are able to register with the corporation their views about the conduct of the corporation's business. In Canada, such right is regarded as a kind of proprietary right and, in the case of federally

\textsuperscript{159} For instance, Employee Share Ownership and Investment Association; and The ESOP (Employee Share Ownership Plan) Association.


\textsuperscript{161} It should be noted that non-voting shares are also permissible under both the CBCA and CCL.
incorporated corporations, it is specifically recognized by the CBCA.¹⁶² Though China has not clearly defined the right to vote as a proprietary right, nevertheless, shareholders' right to vote is legally protected.¹⁶³

A CBCA's Majority Rule: Democracy Based on Capital

(1) Shareholders' Statutory Power under the CBCA

Under the CBCA, shareholders, through shareholders' meetings and by voting, have the power to elect and remove directors;¹⁶⁴ approve fundamental corporate changes including (but not limited to) amendments to articles and amalgamation,¹⁶⁵ a continuance under the laws of another jurisdiction,¹⁶⁶ a change in the by-laws,¹⁶⁷ a sale of all or substantially all of the assets of the corporation,¹⁶⁸ and to appoint and remove auditors.¹⁶⁹

Directors must, at the annual meeting, present shareholders with the annual financial statements.¹⁷⁰ Relying on the financial reports, shareholders review the corporate performance, the performance of directors and other corporate agents.

¹⁶² CBCA s.140 (1).
¹⁶³ Article 106 of CCL.
¹⁶⁴ CBCA ss.106 (3) and 109 (1).
¹⁶⁵ CBCA ss.173 (1) and 183.
¹⁶⁶ CBCA s.188.
¹⁶⁷ CBCA s.103.
¹⁶⁸ CBCA s.189 (3).
¹⁶⁹ CBCA ss. 162 (1) and 165 (1).
¹⁷⁰ CBCA s.155 (1).
In addition, CBCA shareholders also have the right to make proposals relating to the articles or by-laws, or any other matter in connection with the business and affairs of the corporation to be discussed at shareholders' meetings, to appoint proxy-holders, and to access certain corporate information. The right of each shareholder to make a proposal allows shareholders to initiate discussion and express their concerns with the corporate management. Proposals cannot be easily ignored by managers since the CBCA requires that proposals be heard, considered and voted upon by the constituency of shareholders.

(2) Voting: One Share, One Vote

Shareholders most frequently exercise their statutory power as discussed above for controlling the corporation or registering their preferences through voting at shareholders' meetings. The general rule of voting in CBCA corporations, unless the articles provide otherwise, is one share, one vote, a rule that effectively establishes a shareholder democracy based on capital. Because the CBCA permits a corporation to have different classes of shares with different voting rights (i.e. voting shares, non-voting shares, or super-voting shares subject to provisions in the articles), Canadian

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171 CBCA ss.137 (1) and 103 (5).
172 CBCA s.148 (1).
173 CBCA s.21 (1).
174 CBCA s. 137.
175 CBCA s.140 (1).
176 CBCA s.140.
corporate decision-makers have the opportunity of raising a large amount of equity without losing control. 177

(3) The Majority Rule

Shareholders voting operates on the basis of majority rule, a concept stemming from political democracy practices. That means shareholders with a majority of voting shares govern the corporation. 178 Majority rule is a doctrine based on the theory that corporations are capitalist institutions and shareholders are property owners of shares. In a widely-held public corporation, shareholders' democracy cannot be realized unless members of the shareholder group become active participants in corporate life. In a public corporation with high ownership concentration and in a closely-held corporation, the majority rule relates more to the discretion of the controlling shareholder or a small group of controlling shareholders.

However, majority rule under the CBCA is not absolute. It is mitigated by a

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177 This contributes to the high concentration of ownership in Canadian corporations. Other factors that account for this phenomenon include Canada's resource based economy, a political need for establishing an integrated national economy in this country owing to the combination of its vast geographical space and limited population, and the emergence of institutional shareholders. See 4.1.3 B (1) in this thesis.

178 Subject to super-majority and class voting requirements in certain instances as discussed above.
number of statute-based minority shareholder protection remedies, such as class veto,\textsuperscript{179} the appraisal remedy,\textsuperscript{180} voting protections for minority shareholders (such as cumulative voting and class-elected directors),\textsuperscript{181} derivative\textsuperscript{182} or personal actions and the oppression remedy.\textsuperscript{183}

(4) The Reality

Shareholders' power in controlling a corporation in reality depends on the type of corporation, provisions under corporate law and the articles or other contractual documents. Since the CBCA dictates that the directors should manage the business and affairs of the corporation,\textsuperscript{184} Canadian shareholders' power in controlling the business of the corporation is largely reduced particularly in the case of large widely held public corporations (see Appendix II - A). Most shareholders in large widely held public corporations are minority shareholders and are uninterested in corporate affairs given the small amount of wealth they invest in the corporations. Thus, corporate controlling

\textsuperscript{179} CBCA s.176.
\textsuperscript{180} CBCA s.190. The appraisal remedy permits dissenting minority shareholders to opt out of the corporation and receive fair compensation.
\textsuperscript{181} Cumulative voting assures that minority shareholders can have some representation on the board. For a description of cumulative voting, see CBCA s.107 and supra note 42 (Dickerson Report) para.76 at 216. For class voting, see CBCA ss.111(3) and (4). In order to prevent majority shareholders from impugning the cumulative voting and class voting rights, CBCA ss. 107(g) and 109(1). (2) provide back-up rules for enforcing these rights by minority shareholders.
\textsuperscript{182} CBCA s.239.
\textsuperscript{183} CBCA s.241. The definition of "Complainant" in s.238 of the CBCA guarantees shareholders the right to commence a derivative and oppression action.
\textsuperscript{184} CBCA s.102 (1).
power more often lies in the hands of corporate management. The chief executive officer, depending on his/her specific role in such corporations, very often becomes the *de facto* corporate governor. Although a more flexible management structure is allowed through a unanimous shareholder agreement, such a device is limited to closely-held corporations,\(^{185}\) given that it is hardly possible to get a unanimous agreement among numerous shareholders.

In the case of a public corporation with high ownership concentration, which is a distinctive feature of Canadian corporations, a relatively small group of shareholders or perhaps a single controlling shareholder may legally or effectively hold a majority of voting shares and so be able to exercise decision power. Even shareholders who own directly or indirectly as little as 20 per cent of the voting shares of a corporation can often exercise considerable power in the absence of other major controlling shareholders (see Appendix II - B).

In the case of closely-held corporations, shareholders are able to direct corporate business simply because shareholders more often are willing and eager to become the corporate management members given that most of the shareholders' wealth is typically put into such corporations (see Appendix II - C).

An examination of the three types of corporations in Canada leads to the following conclusion: from the shareholder's perspective, the more concentrated capital (represented by voting shares) that is contributed into one corporation, the greater the corporate decision power that can be obtained in such corporation. The corporate controlling power is closely associated with the amount of equity capital invested.

\(^{185}\) *Supra* note 42 (Dickerson Report) at 70.
B  CCL's Majority Rule: Socialism Embracing Capitalism

(1)  Shareholders' Statutory Power under CCL

Compared with the CBCA, CCL vests shareholders with more extensive powers. It is clearly stated under CCL that the shareholders' meeting is the most powerful organ in a corporation. In terms of shareholders' statutory power, CCL provides that the shareholders have the power to decide business policy and the investment plan of the corporation; to examine and approve the annual financial budget plan and final accounts plan; to adopt resolutions on the issuance of corporate bonds; to adopt resolutions on merger, division, transformation, dissolution and liquidation; to adopt resolutions on increase or reduction of the registered capital of the corporation; to amend constitutional documentation; and, more notably, to examine and approve plans of

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186 It should be noted that FIEs in China do not have the institution of shareholders’ meetings. The board of directors is the most powerful organ in FIEs and statutorily has the right to decide all corporate matters.

187 Articles 37 and 102 of CCL.

188 Article 38 (1) of CCL.

189 Article 38 (6) of CCL.

190 Article 38 (9) of CCL.

191 Article 38 (11) of CCL.

192 Article 38 (8) of CCL. Registered capital of a limited liability company refers to the amount of the paid-up capital contribution of all of its shareholders as registered with the state company registration authority (see Article 23 of CCL). Registered capital of a joint stock company refers to the total amount of the paid-up capital as registered with the state company registration authority. (see Article 78 of CCL).

193 Article 38 (12) of CCL.
distribution of profits and recovery for losses. Many of the shareholders' statutory powers as listed above are reserved for management in a CBCA corporation.

Shareholders' power over managerial matters also includes the power to examine and approve reports of the board of directors and the supervisory board and to elect and remove members of the board of directors or members from the supervisory board who represent the shareholders, and to set their remuneration.

In the case of a closely-held corporation (i.e., a limited liability corporation incorporated according to CCL), share transfers to outsiders (that is any third party other than the shareholders of the corporation) must be approved by the shareholders' meeting. This provision has recognized the reality that closely-held corporations are, to some extent, more like partnerships since trust between corporate members largely decides the fate of such corporations. Such share transfer restrictions are an effective means for shareholders to control closely-held corporations, maintain a corporation as a close corporation and ensure continuity of the corporation.

(2) Voting: One Share, One Vote

Shareholders of corporations incorporated under CCL exercise their statutory

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194 Article 38 (7) of CCL.
195 Articles 38 (4) and 38 (5) of CCL.
196 Articles 38 (2) and 38 (3) of CCL.
197 Article 38 (10) of CCL.
198 It is noted that restriction on transfers of shares in a closely-held corporation is also anticipated by the CBCA. See CBCA ss. 6(1)(d), 49(8), and 173. The CBCA requires any limitation on the share transfer to be included in the articles of incorporation or articles of amendment.
power as mentioned above through voting. Like the concept of shareholder's democracy adopted by the CBCA, the general voting rule under the CCL is also one share, one vote. Adoption of this principle indicates that the Chinese government and lawmakers recognize capitalism in the context of corporate management and are prepared to abolish the traditional socialist enterprise management model, characterized by state administrative intervention in the management of enterprises. Moreover, CCL permits shares to carry different voting rights. In this regard, Chinese corporate decision-makers, like their counterparts in Canada, are able to raise certain equity without sacrificing control position.

(3) The Majority Rule

Majority rule is also recognized under the CCL. Though practically the state and business community have provided for a unique classification of shares as described in 4.1.2 above, theoretically, the legal community in China prefers to categorize shares into ordinary shares and preference shares, a classification similar to that of Canada. Ordinary shares constitute the residuary class in which is vested the right to receive dividends and the right to receive distribution of the assets of the corporation upon a winding up or insolvency after the special rights of other classes, if any, have been satisfied. Within ordinary shares, distinctions might be drawn by dividing them into different classes of shares with different rights. But generally, only ordinary shareholders can have voting

199 Article 106 of CCL.

200 Articles 106 and 107 of CCL.
rights and vote on all matters presented at the shareholders' general meetings. The voting is operated on the basis of majority rule. In case of fundamental changes, such as merger, division, dissolution, or amendments to articles of association (corresponding to articles of incorporation under the CBCA), not less than two-thirds of the votes are needed. Preference shares are types of shares that confer on the holders some preference over other classes in respect either of dividends or of repayment of capital or both. Preference shareholders can only have rights to vote in relation to matters that affect their rights (e.g., the corporation failing to pay dividends as prescribed by the corporate constitution) or after the occurrence of specified events.

Politically or economically, majority rule is often deemed a democratic principle in both capitalist and socialist countries. Shareholders' democracy, however, is largely based on shareholders' ability to comprehend financial reports of the corporation. If most investors are not able to grasp the meaning of corporate information, majority rule will have its drawbacks in terms of emphasizing "quantity rather than quality." The fact in China is that most Chinese individual investors (most of them are household investors) may not have the ability to understand fundamental financial terms. Therefore, they may not be able to make reasonable decisions even if they are presented with full, accurate, and timely corporate information. Of course, it is also not clear to what extent individual Canadian investors can actually understand corporate information or make reasonable informed decisions when they are presented with complex corporate financial information. However, even assuming that most Canadian investors are not able to comprehend

201 Article 106 of CCL.

202 H. J. Glasbeek, "Democracy for Corporations: Corporations Against Democracy" in Faculty of Law, McGill University, Conference Meredith Lectures 1994/95, Corporations at the Crossroads (Montreal: McGill University, 1995) at 500.
corporate financial information on their own, Canadian investors at least have readily available assistance from professional investment advisors; and thus, majority rule can be exercised in Canada of a relatively high quality. The absence of professional investment advisors in China, however, very likely results in the exercising of majority rule on the basis of "quantity rather than quality".\textsuperscript{203}

(4) Socialism Embracing Capitalism?

It seems that China acknowledges capitalism in corporate decision-making since CCL accepts the notions of "one share one vote" and majority rule. But it is doubtful that Chinese shareholders' democracy can be solidly and purely established on the basis of capitalism. As a socialist country, the economic reform and free market measures adopted by the Chinese government are different from those that prevail in a western free market economy. Employing the wording in China's Constitution, this country is adopting a "socialist market economy".\textsuperscript{204} Simply put, China is making efforts to reduce state administrative intervention in economic life (including in corporate life), while still emphasizing state control in the country's economy. The control is typically reflected in the predominant position of state ownership in China's macro-economy. The socialist market economy is a state policy that embraces conflicts. Reflecting on corporate law,

\textsuperscript{203} Ibid.

\textsuperscript{204} Article 15 of 1993 Constitution of the People's Republic of China. (Adopted at the Fifth Session of the Fifth National People's Congress and Promulgated for Implementation by the Proclamation of the National People's Congress on December 4, 1982, as amended at the First Session of the Seventh National People's Congress on April 12, 1988, and again at the First Session of the Seventh National People's Congress on March 29, 1993) English version is available online. Online: Maryland University School of Law, China Law Website <http://www.qis.net/chinalaw/lawtran1.htm> (date accessed: June 16, 1999).
Article 4 of CCL offers an example of such conflicts. Article 4 provides that, \(^{205}\)

The shareholders of a corporation shall, in their capacity of contributors of capital, enjoy such rights of owners as benefiting from assets of the corporation, making major decisions and selecting managerial personnel in accordance with the amount of their respective capital investment in the corporation.

A corporation shall enjoy the right to the entire property of the legal person formed by the investments of shareholders and shall possess civil rights and bear the civil liabilities in accordance with the law.

The ownership of state-owned assets in a corporation shall vest in the state.

(Emphasis added)

The conflict contained in Article 4 is obvious. Article 4 on the one hand provides for shareholders democracy on the basis of the capital invested by shareholders and specifies that a corporation is a legal person enjoying the property right of the corporation; on the other hand, it clarifies that state assets in a corporation belong to the state. If the state has title to the assets (i.e. the assets have not been sold or otherwise transferred to the corporation for consideration), how can they be the property of the corporation? One of the consequences of incorporation is to establish an independent legal personality. That is, incorporation enables the property of the corporation to be clearly distinguished from that of investors (i.e. shareholders), and the investors have no direct proprietary rights to the corporate property but merely to their shares. Paragraph 2 of Article 4 clearly recognizes the independent personality of a corporation. But paragraph 3 is in obvious conflict with the preceding two paragraphs.

\(^{205}\) Article 4 of CCL (English version) is available online. Please see China Internet Information Center, China's Economy and Its Enterprises - Economic Laws and Regulations, <http://www.china.org.cn/> (date accessed: June 17, 1999).
Article 4 of CCL provides a specific example of China's Corporate Laws borrowing modern corporate doctrines from western countries; and trying to align western corporate doctrines into China's socialist regime. The aim of paragraph 3 of Article 4 is likely to frustrate fraudulent transfers of state assets into the private sector. But it causes considerable confusion as to the theory of independent status of a corporation and such corporation's ownership of its assets. If protecting state assets comes at the expense of disregarding independent legal personality of a corporation, it is not clear that market credibility can be firmly established in this country. If China decides to embrace capitalism in respect of shareholders' democracy, Chinese lawmakers should consider amending the socialist doctrine where such doctrine is in conflict with capitalist doctrine. One of socialism's fundamental doctrines regarding public property, as provided in China's constitution is, "socialist public property is inviolable". Thus, paragraph 3 of Article 4 might find its origin in this principle. However, inviolable public property can be protected by other means (e.g., by penalizing corruption, reprimanding the unlawful transfer of state assets, etc.), rather than through impairment of the founding principles of incorporation.

(5) The Reality

The practice of CCL in terms of corporate management is to split the business and affairs of a corporation into corporate strategic matters and matters in the ordinary course

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of business. Shareholders, through shareholders' meetings, control the former and the board of directors handles the latter (see Appendix III – E). Where corporate matters require specific business skills, or types of matters require frequent decisions to be made, or certain business matters must be handled with greater speed, the board of directors and managerial officers are expected to make the decisions. In the case of more strategic corporate matters or matters concerning greater economic significance, shareholders are more likely to make decisions themselves.

In reality, whether shareholders can have the power to direct corporate affairs largely depends on the type of the corporations as well as particular provisions under the laws and the corporation's articles. With regard to public corporations in China, individual shareholders can never be controlling shareholders because of regulatory prohibitions in China. In China, under current regulations, individual investors are not permitted to purchase more than 0.1 per cent of listed public corporations. Therefore, the state or other legal persons hold the majority of voting shares in every listed public corporation. In the case of a public corporation where the state holds a majority of the voting shares (i.e. state shares occupy the dominant position in the public corporation), the state, through its delegates who manage the corporation, exercises the ultimate decision power. State policy is more often reflected in the decisions of such corporations (see Appendix III – A). Other shareholders, including other companies or individual shareholders, may be frustrated if they want to register their dissent given that minority shareholders in China are given few legal weapons to fight against the majority.

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208 Minority shareholders' influences on corporate control will be discussed in 4.1.5 of this thesis.
In the case of a public corporation where other legal persons\textsuperscript{209} hold a majority of the voting shares (i.e. legal person shares occupy the dominant position in the corporation), such legal persons may, through their management, exercise the controlling power by voting and directing the corporate business (see Appendix III - B).\textsuperscript{210} But the state, as a minority shareholder, can very likely register its opinion with the corporation given that legal persons always want to keep a good relationship with local or central governments. Accordingly, legal persons usually pay special attention to the concerns of the state. As to individual investors, they are in a disadvantageous position given that they have neither the political influence of the state nor any effective power under the CCL to keep the majority shareholders in check.

In practice, shareholders' decision-making very likely relies on the information and recommendations provided by the board of directors and managerial officers since most shareholders either do not have any interest in corporate management, or lack managerial expertise, enthusiasm or commitment to the corporation (particularly when the state or legal persons have diversified portfolios in various corporations).\textsuperscript{211}

In the case of unlisted public corporations (see Appendix III - C), shareholders usually include the state, legal persons and employees. Such corporations are frequently incorporated from old state-owned enterprises. The process of privatization typically turns employees into shareholders. The consequence of such an incorporation is that the corporation can raise funds from its employees at low cost. In addition, employees will

\textsuperscript{209} Supra note 108.

\textsuperscript{210} For a description of legal persons in China, see note 108, supra.

\textsuperscript{211} For an interesting perspective on these issues, see Jiang Hezi, "Annual Shareholders' Meeting: The Place that Shareholders Disappointed", Online: Securities Times,
have great commitment to the corporation. The corporation, however, with such diversified owners, often encounters competing interests. But generally, the state has the greatest influence upon corporate matters partly because of a long-term tradition and tendency carried over from the management mode of state-owned enterprises.

In the case of closely-held corporations, such as sino-foreign investment enterprises (see Appendix III – D), though the FIEs Laws provide that the board of directors is the highest organ in the corporation,\(^{212}\) in reality, before making major corporate decisions relating to strategic matters, the board members appointed by different investors always submit such matters to the investors.

The above analysis in respect of shareholders' controlling power in Chinese corporations reveals that currently individual shareholders do not play a significant role in corporate affairs notwithstanding the fact that shareholders generally are given extensive statutory power in corporate decision making by CCL. The discriminatory treatment of individual shareholders under CCL is also reflected in the share structure of bearer shares held by individual investors. The weak position of individual shareholders arises from the regime of China's politics and economy and culture. The socialist system is a regime in which public ownership dominates.\(^{213}\) Private economy in China cannot predominate as long as the law prohibits individuals from becoming controlling shareholders. In addition, most Chinese people do not exercise their rights as investors. The notion of individual legal rights originating from private property is a new concept in the Chinese culture (see

\(^{212}\) See 4.2.1. B of this thesis. See also Article 34 of Implementation Regulations of EJV Law and Article 24 of Implementation Rules of CJV Law.

\(^{213}\) Supra note 123.
5.5.2 below). It is likely to be a long time before China's individual investors may be expected to play a material role in controlling or influencing corporate affairs.

The reason for focusing here on mixed ownership corporations, rather than pure (100 per cent) private business corporations, is that in China, in terms of business corporations (that is corporations with the objective of pursuing profits), such mixed ownership corporations are the norm during the current transitional economic reform age. The following chart cited from 1997 China Statistics Yearbook reflects the general economic structure of China. Strictly speaking, references to "corporations" only include the shareholding units as shown below. However, considering the private sector nature of foreign funded enterprises, I have also included reference to the control situation of foreign investment enterprises established according to FIEs Laws in this thesis. Hong Kong, Macao and Taiwan investment companies in China also follow the FIEs Laws, and such companies are included in my discussion of foreign investment companies. Private enterprises, that is purely private economic institutions, however, do not fall into the shareholding structure and are not governed by China's Corporation Laws. Among the shareholding economic units, pure private business corporations (that is, corporations without funds from the state) are few.

Structural Indicators on National Economic and Social Development:

214 Article 57 of Implementation Rules of CJV Law; and Article 85 of Implementing Rules of WFOE Law. Although no similar articles are provided by EJV Law or Implementing Regulations of EJV Law, practically, EJV Law and Implementing Regulations of EJV Law apply to equity joint ventures between Hong Kong, Macao or Taiwan Investors and Chinese investors.

215 However, I do not have detailed data on this point.

### Structure by Ownership

<table>
<thead>
<tr>
<th>Ownership Type</th>
<th>1985 (%)</th>
<th>1990 (%)</th>
<th>1995 (%)</th>
<th>1996 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Owned Units</td>
<td>18.0</td>
<td>16.2</td>
<td>16.6</td>
<td>16.3</td>
</tr>
<tr>
<td>Collective Owned Units</td>
<td>6.7</td>
<td>5.6</td>
<td>4.6</td>
<td>4.4</td>
</tr>
<tr>
<td>Joint Owned Units</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Shareholding Units</td>
<td></td>
<td></td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Foreign Funded Units</td>
<td>0.1</td>
<td>0.4</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>Funded by Enterprises from Hong Kong, Macao and Taiwan</td>
<td>0.01</td>
<td>0.4</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>Other Economic Units</td>
<td></td>
<td></td>
<td>...</td>
<td>0.02</td>
</tr>
<tr>
<td>Private Enterprise</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual Industry And Commerce Household Units</td>
<td>0.9</td>
<td>1.0</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Farms Engaging in Farming, Forestry, Animal Husbandry And Fishing</td>
<td>74.3</td>
<td>74.0</td>
<td>71.9</td>
<td>71.2</td>
</tr>
</tbody>
</table>

### 4.1.5 Minority Shareholders' Influences on Corporate Control

Although the corporation is an economic structure and majority shareholders can more easily register their discretion with the corporation, this does not mean that minority shareholders have no influencing power over corporate business.

### A Under the CBCA

Notwithstanding that the CBCA provides majority shareholders a high degree of power to control the corporation, it also offers minority shareholders legal devices to express their will and protect their interests in the corporation. The treatment of majority-minority shareholders' relationships under the CBCA reflects a development in corporate law from an unmitigated application of the principle of majority rule to an emphasis upon protection of minority interests on the basis of equity and fairness.217

In general, minority shareholders have the right to make a proposal,218 to requisition a shareholders' meeting;219 to a class veto;220 to apply to a court for an investigation or inspection of the corporate affairs;221 to dissent and appraisal;222 to initiate a derivative action223 or personal action;224 to claim for an oppression remedy,225 and to propose the voluntary liquidation and dissolution of a corporation.226 In addition, the design of cumulative voting under the CBCA enables minority shareholders of corporations that have adopted such voting provisions to have a greater voice in the

217 See an analysis of the majority-minority shareholders' relationship in an early case North-West Transportation Co. Ltd. v. Beatty (1877), 12 A. C. 589 (P.C.).

218 CBCA s.137. That is, a shareholder proposal. This right can be exercised by any registered shareholder.

219 CBCA s.143. A pre-condition is that the shareholder who intends to exercise this right should hold not less than 5 per cent of the corporation's voting shares.

220 CBCA s.176.

221 CBCA s.229.

222 CBCA s.190. A dissenting shareholder may, under certain statutory terms and conditions, require the corporation to pay him the fair value of the shares held by him in case the corporation makes a major change.

223 CBCA ss.238 and 239.

224 Pender v. Lushington (1877), 6 Ch. D. 70 (C.A.).

225 CBCA s.241.

226 CBCA s.211.
election of directors.\textsuperscript{227}

This thesis however does not purport to go through all the rights that minority shareholders have under the CBCA for striking a balanced relationship with the majority. Rather, it will deal with few specific legal devices provided by the CBCA for protecting minority shareholders' rights (and in some cases the interests of other corporate stakeholders) which are particularly foreign to the Chinese people.

(1) Appraisal Right\textsuperscript{228}

The CBCA appraisal right, based upon New York's Business Corporations Law, paves a new way for balancing the relationship between the majority and minority shareholders.\textsuperscript{229} It enables shareholders to get the corporation to buy their shares at fair value upon the occurrence of certain events which fundamentally change the corporate constitution, such as a sale of all or substantially all of the assets of the business; removal, addition, or alteration of restrictions on the business or businesses the corporation may carry on, or of the right to transfer shares; alteration of the terms of outstanding securities; continuance in another jurisdiction; and amalgamation.

The purpose for including the appraisal right, according to the Dickerson Report, was this:

\textit{... Instead of relying on common law standards to restrict the conduct of majority shareholders who propose to make a fundamental change, the provisions in this Part confer upon a

\textsuperscript{227} Supra note 42 (Dickerson Report) para. 206 at 73.

\textsuperscript{228} CBCA s.190.

\textsuperscript{229} J. G. MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1986) 24 Osgoode Hall L. J. 201 at 204.
shareholder who dissents from the fundamental change the privilege of opting out of the corporation and demanding fair compensation for his shares. ... Instead of placing the minority shareholder at the mercy of the majority, these provisions permit the minority shareholder to withdraw from the enterprise and, if enough minority shareholders are affected, to bar the proposed change. Nevertheless, the majority shareholders can, if they go through the proper formalities, and if they pay any dissenting shareholders, effect almost any fundamental change with impunity. The result is a resolution of the problem that protects minority shareholders from discrimination and at the same time preserves flexibility within the enterprise, permitting it to adapt to changing business conditions... 230 (emphasis added)

Therefore, the functions of the appraisal right, in the view of the Dickerson Committee, are anti-discrimination, preserving "flexibility", and making the CBCA "self-enforcing". 231 Moreover, the appraisal right is non-exclusive of other shareholder remedies. 232

This "opting out" remedy is especially significant for minority shareholders of closely-held corporations with a restricted market for their shares 233 and for dissenting shareholders of corporations whose shares trade in illiquid markets. To shareholders of a broadly traded publicly-held corporation, the appraisal right as a means of exiting the corporation is of little value since they can generally sell out their shares at relatively low cost. 234 But the vast bulk of Canadian public corporations do trade in thin markets, that is,

230 Supra note 42 (Dickerson Report) para. 347 at 115.

231 Ibid. para. 476 at 158.

232 Supra note 229 at 205. "it was designed to supplement and not supplant alternative remedies to which the shareholder might have resort."


234 Supra note 229 at 218 - 221.

MacIntosh has argued, citing M. A. Eisenberg, that in the case of public corporations with deep equity markets, large shareholders who are forced to sell out shares quickly to escape fundamental changes may realize an inferior price in the market because of the hurried liquidation of the large block. Furthermore, shareholders may only be able to obtain a price for their shares that already reflects the market's
their securities are inactively traded. A risk of trading in a thin market is that the market price of securities is more readily subject to short-run fluctuation. In such circumstances, shareholders in thin markets are in greater need of the protection that is provided by the appraisal right.

Though the appraisal right has certain weaknesses which will be observed in 4.1.7 B (1) below, given the benefits that the appraisal right offers to minority shareholders, it has been widely adopted in the corporate statutes of most Canadian provinces as well as the CBCA.

(2) Derivative Action

The derivative action permitted under the CBCA provides minority shareholders, as well as other stakeholders, in Canada an effective means to initiate an action on behalf of the corporation against directors, managerial officers, and other third parties to redress wrongs done to the corporation. The legal device of the derivative action addresses the problem that arises from the conflicting theories of independent legal personality of a corporation and shareholder majority rule. The availability of derivative actions promotes anticipation of the effect of the fundamental change. Therefore, for shareholders of such public corporations, the appraisal right serves as protection against the cost of sale of a large block.


236 Supra note 229 at 214.

237 CBCA ss.2, 238, 239, 240, and 242.

238 CBCA s.239. CBCA s.238 provides a broad definition of "complainant". There are certain pre-conditions that a "complainant" has to meet before initiating a derivative action.
managerial responsibility and accountability because it ensures that shareholders can enforce rights to which the corporation is entitled or recover property belonging to the corporation where managers or the directors refuse to take action particularly in the case of corporate mismanagement.

The derivative action is different from personal actions by shareholders against the corporation. Personal actions involve direct claims by shareholders for damages suffered by them (arising for example, from inadequate disclosure in an information circular, or violation of proxy rights) caused by wrongdoing by the corporation. Derivative actions, however, generally involve claims of the corporation against third parties directed at obtaining or retaining a benefit belonging to the corporation. 239

But the derivative action is seldom used in Canada. 240 The reasons are that wrongdoing by the management of a corporation can be difficult to uncover when the wrongdoers are in control of the corporation, and in any event, there may not always be significant financial incentive to commence a derivative action since the relief granted in a successful derivative action generally flows to the corporation rather than to the complainant. 241

(3) Oppression Remedy


241 *Ibid.* However, CBCA s.240 (c) further provides that the court may make an order directing that any amount adjudged payable by a defendant in the action should be paid (in whole or in part) directly to former or present security holders of the corporation instead of to the corporation.
The oppression remedy provides minority shareholders in Canada with access to the courts in cases where they have been oppressed by the majority shareholders and/or corporate management. Thus, the minority shareholders have the power to protect themselves against the majority and so to challenge the basic tenet of corporate law that the will of the majority must be respected (with certain exceptions like fraud\textsuperscript{242}). In the meantime, the legislators put teeth into the section by giving the court the power to make almost any kind of order to remedy an oppressive or unfairly prejudicial act or use of power. The device of the oppression remedy facilitates courts' intervention in corporate management through potentially expansive interpretation of vague terms under the CBCA, such as "oppressive", "unfair" or "prejudicial".\textsuperscript{243} The philosophy underlying the oppression remedy is to allow the courts to "continue to develop the common law of

\textsuperscript{242} The majority rule was set out in the case of Foss v. Harbottle (1843), 2 Hare 461, 67 E. R. 189. Foss v. Harbottle mainly established two propositions: first, a shareholder has no locus standi to sue on the Company's behalf where the breach complained of was a wrong done to the company (this point is beyond the scope of this section of the thesis); and second, majority shareholders in general meeting, have, both at common law and by the terms of incorporation of the company, power to bind the whole body and ultimately control the destiny of the company. See also S.M. Beck, "An Analysis of Foss v. Harbottle" in J.S. Ziegel ed. Studies in Canadian Company Law (Toronto: Butterworths, 1967) 545.

The exceptions to the so-called "rule in Foss v. Harbottle" were listed by Jenkins L.J. in Edwards v. Halliwell, [1950] 2 All E.R. 1064 at 1067 (C.A.):

"It has been noted in the course of argument that in cases where the act complained of is wholly ultra vires the company or association the rule has no application because there is no question of the transaction being confirmed by any majority. It has been further pointed out that where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favor of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue. ... There is a further exception, ... the rule did not prevent an individual member from suing if the matter in respect of which he was suing was one which could validly be done or sanctioned, not by a simple majority of the members of the company or association, but only by some special majority, as, for instance, in case of a limited company under the Companies Act, a special resolution duly passed as such. ... the rule has no application at all, for the individual members who are suing sue,... in their own right to protect from invasion their own individual rights as members." (emphasis added)

\textsuperscript{243} CBCA s.241 (2) defines an oppressive act (or conduct) as any act or conduct "that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, directors or officer, the court may make an order to rectify the matters complained of."
responsibility of corporate management unhindered by the legal fetters created at a time when courts were preoccupied with enforcing 'democratic' structures" given that very broad quality standards can accommodate corporate law in a very "fluid" state.\textsuperscript{244} It appears that in modern Canadian business society, it is the courts that decide many questions of business ethics.

Such standards set by the CBCA have been the subject of criticism. It has been argued that the application of the oppression remedy allows the courts to violate previously cherished tenets of corporate law, ignoring the corporate persona, extensively re-ordering corporate affairs relying upon the judge's own assessment of the business, and giving remedies to others for wrongs once regarded exclusively as the corporation's own.\textsuperscript{245}

It seems that a policy of \textit{laissez-faire} is not acceptable in Canada in the latter part of the twentieth century, and equity has gained the upper hand.\textsuperscript{246} The disadvantage that the oppression remedy brings is potential uncertainty and unpredictability in corporate affairs. However, though the CBCA casts the oppression remedy in vague terms, the more the oppression remedy is used by complainants, the more it will become clear what behavior is or is not acceptable to the courts.\textsuperscript{247}

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{244} \textit{Supra} note 42 (Dickerson Report) para.477 at 159.
\item \textsuperscript{247} This conclusion, however, is based on the assumption that courts will strictly follow precedent and on an assumption that they will endeavor not to provide conflicting judgements.
\end{enumerate}
\end{footnotesize}
Cumulative Voting

Cumulative voting is a device which provides for minority shareholders to be represented on the board of directors. As the Dickerson Report explained,

The purpose of a cumulative voting system is to enable minority interests to obtain representation on the board of directors by permitting them to multiply the number of shares they control by the number of directors to be elected, and then to concentrate the total number of votes upon a single candidate or group of candidates, and thereby secure the election of their nominees.

In order to prevent the cumulative voting system from being defeated by other devices (such as reduction of number of directors), the CBCA further provides class vote and separate resolution provisions.

Since cumulative voting is a device that seeks to strike a balance between the interests of minority and majority shareholders, it is very suitable for corporations with high ownership concentration.

B Under CCL

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249 Supra note 42 (Dickerson Report) para 206 at 73.

250 CBCA s.176 (1).

251 CBCA s. 176 (6).

252 However, the use of cumulative voting provisions by CBCA corporations is very rare, presumably because most controlling shareholders are reluctant to share the power to elect the board with minority shareholders.
(1) The Lack of Legal Protection for Minority Shareholders

CCL does not provide sufficient statutory rights for the protection of minority shareholders comparable to those provided by the CBCA. Minority shareholders in China are not equipped with statutory protection such as appraisal rights, an oppression remedy, or cumulative voting. But a shareholder of a Chinese company does have the right to sue for an injunction and damages in case a decision of the board or shareholders' meeting violates laws, administrative rules, or invades the legal interests of the shareholder. CCL does not specify, however, whether the shareholder's right to take action for redressing wrongdoing is based upon a personal right or a derivative right, notwithstanding that theoretically the two differ significantly as analyzed in 4.1.5 A (2) above.

In the absence of comprehensive statutory protection for minority shareholders, in addition to taking a legal action, the only legal weapon left for China's minority shareholders is the super-majority rule. That is, if there is a fundamental change to the corporation contemplated, a super-majority shareholders' approval must be obtained. The absence of sufficient legal protection for minority shareholders is not fortuitous in China. Traditionally, the Chinese are directed that where personal interests are in conflict with the interests of the state or the collective, one should comply with the

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253 Article 111 of CCL.

254 Articles 39 and 40 of CCL for closely held corporations. Articles 106 and 107 of CCL for publicly held corporations.
interests of the state or the collective. Applying such doctrine to Chinese corporate life where individual shareholders' interests are competing with the interests of the state or of legal persons, the interests of the state or the legal person should prevail. As analyzed in 4.1.4 B (5), the state or legal persons always occupy a majority position in Chinese corporations, while individuals are always in a minority position. Thus, application of this doctrine to Chinese corporations leads to a situation where the majority will always be well protected.

(2) Applying CBCA's Minority Shareholder Protection Devices

In the short-term period, it appears unlikely that China's Corporate Laws will be reformed so as to enhance legal protection for minority shareholders. It is unlikely because of certain Chinese cultural values, involving disrespect for private interests, coupled with the business reality that state and legal persons are invariably in the position of majority shareholders. In any event, certain rights provided by the CBCA for the purpose of protecting minority shareholders, like appraisal rights and the oppression remedy, are not applicable in China for the time being.

An effective appraisal right and forced share buyouts (which are the most frequently granted oppression remedies under the CBCA) both require the court to make a determination of the fair value of a holder's shares. The problem is how to assess fair market value of shares in the absence of a mature market system in China. With few

\(^{255}\) The sequence is that the interests of the state are superior to the interests of the collective and to those of individuals. The collective interests are superior to individual interests. This perspective is deeply rooted in the consciousness of the Chinese people who have received communist education.

\(^{256}\) See 4.1.4 B and Appendix III.
sophisticated judges in China, do Chinese courts have the capacity to assess the fair value of shares held by dissenting shareholders? As for derivative actions or personal actions, in a country where people traditionally adopt mediation and negotiation to settle disputes and shy away from initiating actions, to what extent can the availability of such actions help to relieve unjust treatment imposed upon minority shareholders?

4.1.6 Summary

The above sections have examined the role of shareholders and their controlling/influencing power over corporate business under the CBCA and the CCL as well as in the business reality of Canada and China. Corporations as capital institutions facilitate business for the capitalist shareholders. Shares represent the interests and liability of shareholders in a corporation. A comparative examination of share structures under the CBCA, CCL and China's business reality indicates that share structures are closely connected with a nation's social environment, statutory tradition and business reality. The unique classification of shares in China which connects shares with an investor's identity, coupled with a share structure similar to other western countries under the CCL demonstrates that China on the one hand has sought to integrate western corporate experiences into China's Corporate Law, yet on the other hand preserves a socialist regime by carefully monitoring the amount of private capital in the Chinese equity market.

Shareholders exercise controlling/influencing power over corporate business through ownership of shares. A comparative examination of Canadian and Chinese corporate ownership structures shows that Canada and China both have high ownership concentration and that closely-held corporations dominate Canadian and Chinese
corporate markets. Moreover, Canada has a high degree of interlocking ownership and
directorships and China is now taking cautious steps toward developing employee share
ownership. The common characteristics of Canadian and Chinese ownership structures in
corporations may mean that each country will be able to learn lessons from the other in
future.

Shareholders exercise their statutory rights for controlling corporations through
voting. One share, one vote and majority rule are the principal features of democracy
based on capital. Through examination of three types of corporations in Canada, it is
evident that when capital (represented by voting shares) is concentrated in the hands of a
few shareholders, such shareholders are the true governors of the corporation.

Shareholders in China are granted extensive rights to participate in corporate
strategic management. Through adoption of the principles of one share, one vote and
majority rule, it seems that China is embracing shareholder democracy on a capitalist basis.
But the socialism deeply rooted in China appears not to completely embrace capitalism.
Provisions under the CCL in respect of protecting state assets reflect the fact that
socialism is strongly protected during the diversification of Chinese corporate ownership.
Examination of four types of corporations in China demonstrates that individual
shareholders (i.e. the capitalists) are discriminated against by both China's Corporate Laws
and Chinese business practices. Such discrimination is associated with certain features of
China's current economy and the philosophy adhered to by the Chinese people.

It is without doubt that minority shareholders in Canada are well protected by the
CBCA as compared with CCL's indifferent attitude toward minority shareholders in China.
Canadian corporate experiences in respect of protecting minority shareholders on the basis
of fairness and equity may serve as a valuable lesson for Chinese corporate lawmakers in future.

4.1.7 Outstanding Issues

As observed in Chapter 1, corporate control is associated with relationships among people. Proper corporate control should maintain balanced relationships among corporate participants. This section intends to address a number of issues that need to be noted while approaching balanced intra-corporate relationships in Canada and China.

A The CBCA

(1) Differing Treatment for Closely-held Corporations and Publicly-held Corporations

Although the vast majority of corporations in Canada are closely-held corporations and Canadian corporate legal theory makes a clear distinction between closely-held and publicly-held corporations, the CBCA does not provide a corresponding definition or differing treatments of the two types of corporation. The reason for this approach in the CBCA, as explained by the Dickerson Committee, was that it was thought more appropriate for distinctions to be made between public and private corporations on

257 CBCA ss.6(1)(d), 49(8) and 173 deal only with share transfer restrictions. For a discussion of differing treatment for closely-held corporations and public corporations, see F. Iacobucci, M. L. Pilkington, & J. R. S. Prichard, Canadian Business Corporations: An Analysis of Recent Legislative Developments (Agincourt, Ont.: Canada Law Book, 1977).
"functional rather than on doctrinal grounds." Rather than making a broad distinction between public and private corporations for all purposes, then, the CBCA defines corporations in different ways in different sections.259

It is very clear that, as a practical matter, corporate decision making in closely-held corporations is very different from that of publicly-held corporations. Even in public corporations, there are major differences between widely held public corporations and public corporations with high ownership concentration. Shareholders of closely-held corporations are more likely to be involved in managing the corporations and have more commitment to the corporations than shareholders of publicly-held corporations given that shareholders of closely-held corporations contribute most of their wealth to the corporations. Therefore, the CBCA provides shareholders of closely-held corporations a more flexible business structure, which can be similar in ways to a partnership with limited liability.260

As for public corporations with high ownership concentration, a single controlling shareholder or a small group of controlling shareholders are more committed to the corporate business than their fellow shareholders given their more significant investment in the corporation. Because a single controlling shareholder or controlling shareholders of such corporations are often also the directors and/or managers of such corporations, they are very likely the decision-makers. Under such circumstances, there is a great need to

258 Supra note 42 (Dickerson Report) para. 36-38 at 10-11.

259 For instance, some corporations are not required to solicit proxies from their shareholders. See CBCA s.149 (2).

260 It is noted that the CBCA in some respects allows closely-held corporations to avoid much corporate formalism, by, for example, allowing signed resolutions in lieu of meetings (see CBCA s.117), and by providing closely-held corporations the opportunity to adopt a more flexible management structure (see CBCA s.102(1)).
protect minority shareholders' interests.

With regard to shareholders of widely-held public corporations, most, if not all, shareholders of widely held public corporations tend to consider themselves as passive investors rather than active participants in the corporate business. Minority shareholders of high ownership concentration public corporations also have the same tendency. One reason is that professional managers, by virtue of their knowledge and expertise, are usually better qualified to make managerial decisions than shareholders. Another reason is that for an investor who owns shares in a large number of companies, participating in the affairs of one typically will not be worthwhile since the contribution of any single corporation to the overall value of his or her portfolio is probably going to be trivial. In case mismanagement does become a serious concern, such an investor might think that selling the equity is a much quicker and less costly solution than trying to turn the corporation around by attempting to marshal enough support from other minority shareholders to have a material effort on corporate management. Moreover, an investor in a public corporation (in particular, a widely-held public corporation) with a relatively small proportion of personal wealth invested in the corporation is more likely to rely on other shareholders to oversee corporate performance. Actually, many other investors will have the same thought. The result is a "free riding" phenomenon. The fact that a shareholder enjoys limited liability further reinforces shareholders' indifference to corporate decision-making. Professional managers wield controlling power without intervention from shareholders. Under these circumstances, the questions of how to improve corporate

261 Supra note 45 at 458.

internal control and management's accountability to the corporation and shareholders become very important. Given the different business reality in respect of corporate management in closely-held corporations, high ownership concentration public corporations and widely-held public corporations, the CBCA needs to be further refined to deal with the very different business needs of these types of corporations, and the current CBCA "one size fits all" approach, abolished.

(2) Fiduciary Duty Owed by Majority Shareholders

As discussed in the above section 4.1.3, Canadian corporations tend to have high ownership concentration. That is, the will of the majority shareholders can be more readily reflected in the corporate decision-making process. In other words, dominant shareholders might pursue their interests at the expense of minority shareholders.

Although minority shareholders have certain legal rights and remedies under the current CBCA, Canadian courts, historically, have seemed to have a strong sympathy toward the majority shareholders and are reluctant to find a clear fiduciary duty owed by the majority to minority shareholders or to the corporation. In the case Re Jury Gold Mine Development Co., Middleton J. stated that

If [the minority shareholder] chooses to risk his money by subscribing for shares, it is part of his bargain that he will submit to the will of the majority. In the absence of fraud or transactions ultra vires, the majority must govern, and there should be no appeal to the Courts for redress.

263 Refer to 4.1.4 of the text.


265 Ibid. See also Brant Investments Ltd. v. Keeprite Inc. (1987), 60 O.R. (2d) 737, where the Ontario Court of Appeal held that majority shareholders in Canada do not owe a fiduciary duty to minority shareholders.
Such antipathy of the courts towards minority shareholders has its roots in the "internal management rule" developed by Lord Davey, and the "selfish ownership rule" developed in the case of Pender v. Lushington and ultimately traced to Foss v. Harbottle.

Therefore, historically, Canadian courts have adhered to the notion that controlling shareholders owe no fiduciary duties to fellow shareholders or the corporation. If most Canadian public corporations were widely held, with no controlling shareholder, conflicts between controlling shareholders and minority shareholders would be rare. However, Canadian markets are characterized by a high degree of concentrated corporate ownership. This business fact greatly increases the potential conflicts between controlling shareholders and minority shareholders.

The business reality of Canadian corporate markets requires Canadian judges to look beyond common law precedents inherited from a century of jurisprudence, that have

See also the comments of J. G. MacIntosh, "The Role of Institutional and Retail Investors in Canadian Capital Markets" (1993) 31 Osgoode Hall L. J. at 2371.

266 "Burland v. Earle (1902), A.C. 83 (P.C.) at 93. "It is an elementary principle of law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so."

267 Pender v. Lushington (1877), 6 Ch. D. 70 (C.A.) at 75. "Where men exercise their rights of property, they exercise their rights from some motive adequate or inadequate, and I have always considered the law to be that those who have the rights of property are entitled to exercise them whatever their motives be for such exercise."

268 Supra note 242.

found that shareholders owe no fiduciary duties either to their fellow shareholders or to the corporation.\textsuperscript{270}

In the 1970s, the Ontario Court of Appeal appeared to move from the majority rule to an equity and fairness rule and began to consider minority shareholders' interests in the corporation. The Court of Appeal appeared to be prepared to impose a fiduciary duty upon majority shareholders. In the case, \textit{Goldex Mines Ltd. v. Revill}, \textsuperscript{271} the Court of Appeal stated that

The principle that the majority governs in corporate affairs is fundamental to corporation law, but its corollary is also important - that the majority must act fairly and honestly. Fairness is the touchstone of equitable justice, and when the test of fairness is not met, the equitable jurisdiction of the Court can be invoked to prevent or remedy the injustice which misrepresentation or other dishonesty has caused.

In the Canadian legal community, whether majority shareholders today have a fiduciary duty to the minority shareholders or the corporation is a matter of some controversy. Some Canadian scholars argue that the oppression remedy under the CBCA may provide a way of imposing directly or indirectly a fiduciary duty on majority shareholders.

\textsuperscript{270} In addition to the importance of common law precedence, MacIntosh, Holmes and Thompson provide other possible explanations as to why Canadian judges may be reluctant to impose fiduciary duties upon controlling shareholders. Please see J.G. MacIntosh with J. Holmes & S. Thompson, "The Puzzle of Shareholder Fiduciary Duties" in (1991) 19 Can. Bus. L.J. 86. In this article, MacIntosh, Homes and Thompson seek to explain why, in the face of more widespread inter-investor conflicts of interest (given high degree ownership concentration in Canadian corporations), the legal doctrine in Canada has not formally adumbrated fiduciary standards of conduct for controlling shareholders, while the American courts have. Three possible explanations offered by them are as follows: First, since controlling shareholders are often also directors or officers, they are subject, in their capacity as officers or directors, to fiduciary duties, in any event (at 100 – 105). Second, minority shareholders have been protected to a relatively great extent by the existence of widely cast power of review which has allowed the administrators and courts alike to test the fairness of the majority’s treatment of the minority (at 105 - 129). Third, developments under the statutory oppression remedy which have reduced the pressure to impose fiduciary duties on shareholders (at 130 - 134).

\textsuperscript{271} \textit{Goldex Mines Ltd. v. Revill} (1975), 7 O.R. (2d) 216 at 224.
shareholders to either the minority shareholders or the corporation. It seems that Canadian courts will have to further clarify this issue.

(3) Institutional Shareholders in Publicly-held Corporations

As analyzed in Section 4.1.5 above, institutional shareholders, especially pension funds, life insurance companies and mutual funds, hold large equity positions in big and more liquid publicly-held corporations. According to the Task Force on the Future of the Canadian Financial Services Sector,

...many of Canada's financial institutions own investments in public corporations throughout the country that may, particularly in special circumstances, enable the financial institutions to influence managerial decisions of the public corporations. This is particularly the case if investments that are not directly owned by the institutions, but are owned by pooled funds (i.e. mutual funds, pension funds and segregated funds) that are managed by the institutions, are taken into account.

Montgomery's survey demonstrates that today's institutional shareholders in Canada are more likely to take actions for improving corporate performance rather than simply "vote with the feet" (i.e. by selling their shares). Such increased institutional shareholders' participation in corporate management challenges controlling shareholders' rights.


The survey was completed by over 100 Canadian institutions, mainly public and private pension funds and investment counselors.


275 Supra note 273 at 192.
power in corporate decision making.\textsuperscript{276} For example, in the case of a corporation with a controlling shareholder, the provisions of the CBCA regarding special resolutions for fundamental corporate changes could permit an institutional shareholder to defeat a special resolution.\textsuperscript{277}

(4) Shareholders' Communication in Publicly-held Corporations

Shareholder democracy provided by the CBCA can only work if shareholders can be "reached, persuaded, and galvanized to active participation in corporate life."\textsuperscript{278} Without facilitative shareholder communication devices, shareholders' power to control or influence corporate matters will be frustrated. Shareholder proposals under the CBCA provide a platform for registered voting shareholders to bypass the corporate management and place an issue before a shareholders' meetings. As such, a shareholder can participate directly in corporate business and inform other shareholders to take action.

However, the shareholder proposal scheme provided by the CBCA is not without defects. First, the ability of beneficial shareholders whose shares are registered in the name of a depositary or other nominee is curbed.\textsuperscript{279} Some reformers have advocated imposing legal obligations upon intermediaries regarding communication between

\textsuperscript{276} \textit{Supra} note 133 at 172.

\textsuperscript{277} This would only be true, however, if of the controlling shareholder had less than 2/3 of the shares and the institutional shareholder, together with others opposed to the resolution, together hold as least 1/3 of shares present and voting at the relevant meeting.

\textsuperscript{278} \textit{Supra} note 45 at 456.

beneficial shareholders and the corporation under the CBCA.\(^{280}\) Second, as criticized by Professor Welling, though the CBCA provides that individual shareholders have the right to bring a proposal before the shareholders' general meeting, the CBCA fails to clarify the power of the general meeting to rule on the matter of the proposal.\(^{281}\) In other words, the CBCA specifies the procedure of initiating shareholder proposals but neglects to give the general meeting substantive power to deal with the shareholder proposal.\(^{282}\)

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One way to overcome the limitation upon beneficiary shareholders would be for such a shareholder to purchase a single share, register it in his or her name, and submit the proposal after that. The case of *Verdun v. Toronto-Dominion Bank*, [1996] 3 S.C.R.550 raised an issue regarding whether the appellant (J.R. Verdun), as a beneficial shareholder of the respondent bank (Toronto-Dominion Bank), was entitled to have his shareholders proposals included in the respondent’s management proxy circular. In order to submit a proposal, a person must be “a shareholder entitled to vote at an annual meeting of shareholders of a bank”. The Supreme Court had to determine whether a beneficial shareholder is a “shareholder entitled to vote” within the meaning of the Bank Act.

It was held that a beneficial shareholder is not entitled to submit a proposal. Iacobucci J. stated that a shareholder is not without recourse however since he or she may submit a proposal through the registered holder or the beneficial holder may have one or more shares registered in his/her own right. It is also noted that as a general matter some of the shareholder communication problems arising from shares held by a depository or other nominee have been addressed by securities regulations. See e.g. National Policy Statement No.41 - Shareholder Communication (1988/03/18) 11 O.S.C.B. 1242 (NP#41). Under NP#41, an issuer must request and obtain from depository institutions the names of the beneficial shareholders (or other securities holders) on whose behalf the depository institution or other nominee holds the securities before an upcoming meeting of security holders. NP#41 further provides that the depository institution or other nominee must let non-registered security holders know their rights under NP#41, and request written instructions as to whether they wish to receive materials about annual or special meetings of security holders from the issuer.

\(^{280}\) The issue of shareholder communication between beneficial shareholders and registered shareholders has attracted considerable attention from Canadian commentators and law reformers. The Standing Senate Committee on Banking, Trade and Commerce, chaired by Michael Kirby, made 27 recommendations in its report in August, 1996, including recommendations that registered shareholders be furnished, at a fixed period of time, a list that includes all beneficial shareholders. But Intermediaries would be permitted to withhold the names and addresses of beneficial shareholders who have requested in writing that their information not be released. Such a list could be used to enhance the communication among shareholders with regard to the business and affairs of a corporation.

\(^{281}\) *Supra* note 45 at 475.

\(^{282}\) *Ibid.* at 468 - 480. Professor Christopher C. Nicholls of Faculty of Law of Dalhousie University has presented another view of this apparent "defect": If the CBCA provided that any shareholder proposal presented, and passed, at a shareholders meeting of a public corporation required the directors to act in accordance with such a proposal, it is possible that shareholders could approve uninformed proposals since the shareholders do not have access to detailed business information. Indeed, shareholders could never be given access to such information because, in a public corporation, information provided to shareholders is, by its nature, public information. Commercially sensitive information, accordingly, must be withheld, subject to continuous disclosure rules. As a result, shareholders simply do not have sufficient
Further reform of the CBCA may have to address the problem of shareholder communication within public corporations in order to improve shareholders' democracy.

B The CCL

(1) Protection of Minority Shareholders' Interests

As discussed in section 4.1.3 above, Chinese corporations have a high concentration of state/public ownership. The extraordinary rights enjoyed by shareholders with respect to corporate management (see 4.1.4 B (1) above) may permit controlling shareholders more easily to pursue group interests or political aims at the expense of minority shareholders. In China, most of the minority shareholders are individual shareholders. Individual investors are already in a disadvantaged position relative to the state shareholders or other legal person shareholders in terms of information resources and expertise in analyzing corporate information. For minority shareholders in China, who dislike the way management operates, there are only two choices: keep silent or sell one's shares.\(^\text{283}\) Selling shares requires a liquid market. The Chinese securities market is not as liquid as the Canadian market. On the other hand, there are fewer listed corporations in China than in Canada,\(^\text{284}\) which means Chinese investors' opportunity to diversify their

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\(^{283}\) Please note that CCL does not provide appraisal rights to dissenting shareholders.

\(^{284}\) At the end of 1998, there were 454 corporations listed on Shanghai Stock Exchange, and 431 listed on Shenzhen Stock Exchange.
holdings to reduce investment risk is largely restricted. The infant Chinese market system, an absence of a "lawmaking" function on the part of the China's courts, unsophisticated Chinese investors, and a shortage of professional investment advisors and professional experts, like auditors and lawyers, make Chinese investors more dependent upon corporate law (rather than contractual arrangements) to protect their interests and express their wishes to corporate management. If corporate law does not provide sufficient legal remedies to the minority shareholders and allow them to protect their own interests, eventually China will lose capital support from the private sector.

Reforms in Canada have already alleviated the problems associated with the general rule that shareholders holding more than 50 per cent of the voting shares can elect or remove 100 per cent of the board of directors and otherwise pass shareholder resolutions. The solutions are cumulative voting, class veto and separate class resolutions. CCL, however, lacks similar provisions. Chinese law-makers should similarly move from the simple majority rule to a rule emphasizing fairness and equity so as to enhance the credibility of its capital market. In so doing, Canadian experiences in protecting minority shareholders can serve as good examples.

a. Cumulative Voting


285 See 5.4 infra.

286 China does not have a case law system. Judges are not permitted to make law. Generally, they can only apply law according to specific facts. Therefore, the only power to reform law rests with the lawmakers.
As discussed in section 4.1.5 A (4), a cumulative voting system ensures minority shareholders have representation on the board of directors. Examining the business reality of Type A and B public corporations, as demonstrated in the Appendix III - A and III - B, individual shareholders in China very likely encounter the situation that state shareholders or legal person shareholders holding just over 50 per cent of the voting shares are able to elect 100 per cent of the directors.

If Chinese lawmakers want minority shareholders to be represented on the board, a cumulative voting system is a technical provision that can be borrowed from the CBCA. If cumulative voting were adopted however, CCL would also need to address the possibility that a simple majority of shareholders could easily remove a "minority" director originally elected through the exercise of cumulative voting, since CCL states clearly that shareholders have the right to remove a director. Thus, the technical provisions under the CBCA relating to class veto\(^{287}\) and separate resolutions\(^{288}\) as well as the CBCA provision that deals specifically with this "minority director" issue would also need to be taken into account.\(^{289}\)

b. Appraisal Right

As analyzed in section 4.1.5 A(1), the appraisal right allows shareholders to protect themselves against being forced to participate in a corporation that has undergone a fundamental change from the time they initially invested in the corporation. The

\(^{287}\) CBCA s.176 (1).

\(^{288}\) CBCA s.176(6).

\(^{289}\) CBCA s.107(g).
appraisal right is like an "exit" door to dissenting shareholders. Since the appraisal right has certain value for protecting minority shareholders of closely-held corporations, and minority shareholders of public corporations with high ownership concentration or whose shares trade in thin capital markets, it appears that the appraisal right is well suited to China. This is so because, first, China has a vast number of closely held corporations; second, because the Chinese equity market is not highly liquid; and third, because China has a high ownership concentration corporations' market.290

For shareholders of Chinese closely-held corporations and minority shareholders of high ownership concentration public corporations, the chance for withdrawing from the corporation and receiving fair compensation is limited.291 The provision under the CCL requiring that fundamental changes to the corporation must be approved by a super-majority of shareholders292 is a device that may effectively protect minority shareholders in Chinese corporations.

Introducing appraisal rights into CCL would no doubt enhance the ability of minority shareholders to protect their own interests. Further, appraisal rights could serve to protect against unwise or opportunistic fundamental changes facilitated by a management-controlled proxy mechanism in a corporation where the majority of shareholders are uninterested or apathetic. However, at this stage in its development,

290 Refer to 4.1.3 A above and 5.2.1 B below.

291 Article 35 of CCL provides that in a limited liability company (that is a closely held corporation) where a shareholder intends to assign its capital contribution to persons who are not shareholders, the consent of over half of all the shareholders must be secured. Those shareholders disapproving the assignment shall purchase the capital contribution to be assigned. If such shareholders do not make the purchase, they are deemed to have consented to the assignment.

291 Articles 39 and 40 of CCL for closely held corporations. Articles 106 and 107 of CCL for public corporations.
China cannot borrow the Canadian version of appraisal rights since the pre-conditions for effectively exercising the appraisal right (such as, the cultural values, the development of a market economy, sophistication of the courts, etc.) are not satisfied in China as discussed in the section 4.1.5 B (2) above.

In addition, the Canadian experience with appraisal rights raises some serious questions about the value of such rights to Canadian shareholders in any event. China would need to consider these concerns about the appraisal remedy before adopting it. The concerns raised by the appraisal remedy under the CBCA include issues relating to tax costs, brokerage costs, delay costs, procedural hurdles, the expense of exercise, adjudication risk and cost to the corporation as analyzed by Professor MacIntosh.\textsuperscript{293} Tax cost refers to the fact that the election of the appraisal option by a dissenting shareholder may trigger a taxable event for that shareholder. The fundamental change dissented from may or may not also result in a taxable event for a non-dissenting shareholder. The decision of whether to elect to exercise the appraisal right may be influenced by the relative tax treatment accorded dissenting and non-dissenting shareholders.\textsuperscript{294} It is suggested that, irrespective of the rationale and circumstances under which the right is claimed, the appropriate tax treatment of dissenters should be the same as that accorded non-dissenters.\textsuperscript{295} Brokerage costs issues arise on the assumption that the dissentient shareholder reinvests the proceeds arising from the appraisal, so that brokerage fees or


\textsuperscript{294} Ibid. at 344 - 348.

\textsuperscript{295} Ibid.
other reinvestment costs would be added to the appraised value of shares.296 As in the case of tax costs, the objective should be to ensure equal treatment of dissenters and non-dissenters in order to eliminate any artificial incentive to claiming or not claiming the appraisal right. Delay cost is the cost that may arise from the time difference between the date of a resolution adopting the fundamental change, and the date on which a cash payout is made to the shareholder.297 Procedural hurdles refer to the fact that the exercise of appraisal rights requires shareholders to follow detailed technical procedures under the CBCA.298 The expense of exercise relates to the expenses arising from hiring experts to appraise share value. Adjudication risk arises in connection with the considerable uncertainty connected with the current mode of the appraisal remedy under the CBCA.299 Cost to the corporation refers to the fact that the exercise of an appraisal right is beyond the predictable expenses of the corporation and so might deter value-added fundamental changes.300 Moreover, beneficial shareholders are not entitled to invoke the appraisal remedy since only "a holder of shares of any class of a corporation"301 (in other words, only a registered shareholder of shares as indicated in the corporation's share registry) may

296 *Ibid.* at 348 - 349. It was recognized by Professor MacIntosh that added cost at most includes the value of current brokerage costs less the present value of the current brokerage costs that would have been incurred on a future sale in the ordinary course of events.

297 *Ibid.* at 350 – 351. MacIntosh explained that the shareholder who dissents loses all his or her rights as a shareholder, including the right to receive dividends, generally within about one month from the date when the resolution adopting the fundamental change is approved by shareholders. The date when the action approved by the resolution is effective could conceivably be much later than the date at which the dissenting shareholder's capital loses its earning power.


299 *Ibid.*.

300 *Ibid.*.

301 CBCA s.190 (1).
dissent under the CBCA.\textsuperscript{302}

c. Oppression Remedy

The oppression remedy (as addressed in 4.1.5 A(3) above) gets courts involved in corporate affairs. Canadian experience with the oppression remedy requires courts to interpret what constitutes "oppressive", "unfair" or "prejudicial". However, an oppression remedy would not be viable in China for the time being.

First, as discussed in 5.5 below, Chinese traditional culture is a culture characterized by disrespect for private property rights and respect for hierarchy and the Chinese people are non-litigation orientated. Without consciousness of protecting their private property rights and their interests in the corporation, minority shareholders in China are very likely to remain subject to the discretion of the majority shareholders and might not be expected to make significant use of legal actions to protect their interests even if such legal remedies were available. Second, a chilling fact in today's China is that legal education and training has not been developed so as to cultivate sophisticated judges who comprehend corporate business.\textsuperscript{303} Thus, the oppression remedy, relying on courts to

\textsuperscript{302} Bruun and Lansky argued that, if the registered shareholders refused to dissent on behalf of a beneficial owner, the beneficial shareholder would have no appraisal remedy under CBCA, but would perhaps be able to get an order based on equitable principles compelling the registered shareholder to comply with the terms of their trust arrangement. See note 232 at 689, supra.

\textsuperscript{303} Legal education in China is totally different from that of Canada. In China, legal education may be conducted by schools of law in large universities or by politics and law institutes. Law schools and politics and law institutions provide regular legal courses for full-time students admitted through all-China Universities and Colleges Enrollment Examinations (one time per year). Schools of law are supervised by the Ministry of Education, while politics and law institutions are under the supervision of the Ministry of Justice. The Ministry of Justice also operates the Central School for Politics and Law Management Cadres, the Central School for Labor Reform Management Cadres, and schools for the
interpret and provide remedies to the "oppressed" shareholders according to vague terms under corporate law, may not find its setting in China at the moment.

(2) Fiduciary Duty of Majority Shareholders

Though CCL provides for closely-held corporations and publicly-held corporations in different chapters and offers specific definitions of these terms, the provisions relating to shareholder power in closely-held corporations and public corporations are almost the same in both chapters. As discussed in 4.1.4 above and shown in Appendix III, it is apparent that majority shareholders in China legally and practically have too much power and they can effectively direct corporate business even at the expense of minority shareholders' interests, particularly individual shareholders' interests. Therefore, it may be advisable to provide for a fiduciary duty owing by majority shareholders to minority shareholders and to the corporation in the CCL as a means of moving from simple majority rule to the fair and equitable rule.

training of judicial cadres. In order to satisfy people's interest in studying law, some institutions also provide evening courses or correspondence courses.


Article 38(10) of CCL.
The only difference between shareholders' rights and responsibilities in a closely-held corporation and those of shareholders of a publicly-held corporation relates to the assignment of shares. For shareholders of closely held corporations, share transfers to outside investors must be approved by all inside shareholders of the corporation.

It is noted that there is a controversy here. If the existence of legal remedies such as the oppression remedy would not work in China because of the facts mentioned in the preceding paragraph, the provision of a fiduciary duty may also not work at all for minority shareholders in China.
CCL borrowed the concept of shareholder proposals from the west, but CCL's generic provision in respect of shareholder proposals does not seem to effectively ensure that shareholders can actually exercise the proposal right. It states that shareholders of public corporations have the right to propose suggestions relating to corporate business.\(^{306}\) The law does not further clarify whether such a proposal is to be submitted to shareholders' general meetings or to the corporate management. Nor does the law provide a specific procedure that shareholders should follow if they want to exercise the suggestion right. The shareholder proposal is an important legal device to allow shareholders to bypass management and enhance shareholder communication. It is therefore advisable to provide a more detailed and operable provision regarding shareholder proposals under CCL.

This section has provided some general recommendations for further refining corporate internal control under the CBCA and CCL on the basis of striking a balanced relationship among shareholders in Canada and China. The shareholders, who bear the greatest economic risk within a corporation, are the people that one cannot neglect while addressing corporate internal control. In addition to shareholders, however, one must also consider other corporate participants like directors, managers, and employees when studying the subject of corporate internal control. They are to be addressed below.

\(^{306}\) Article 110 of CCL:
"Shareholders shall have the right to examine the articles of association of the company, the minutes of the shareholders' general meetings and the financial and accounting statements, and to make suggestions or inquiries about the business operation of the company." (emphasis added)
4.2 Board of Directors - Control through Statutory Power

4.2.1 Power of Directors in Law and Reality

A Under the CBCA

Theoretically, the very existence of the board of directors and the statutory power that the CBCA confers upon the board of directors\(^{307}\) make the board the corporate decision-maker. This actual decision-making role for the board of directors is a reality in the case of closely held corporations or public corporations with high ownership concentration, but may not be the case in widely-held public corporations.

In reality, as Appendix II-C shows, the board of directors is the corporate decision maker in Canadian closely held corporations given that the role of shareholder, director(s) and managerial officer is often played by one person or by members of a single controlling family. In the case of public corporations with high ownership concentration, as Appendix II-B shows, a single shareholder or a small group of controlling shareholders are able to elect themselves or their nominees as directors and managers. Therefore, those shareholder-directors will be in a position to direct corporate business.

However, the board of directors of widely-held public corporations usually is not the ultimate corporate controller. As Appendix II-A shows, the Chief Executive Officer, for all practical purposes, very likely holds the ultimate decision power.

The role actually played by the board of directors in widely held public

\(^{307}\) CBCA s.102(1).
corporations is considerably circumscribed because the board is more likely to leave corporate management to managerial officers, a fact confirmed by Professor Mace in his field study in the 1970s.  

In modern public corporations, the role of the board of directors has been defined as that of a monitor, rather than a manager, of the corporation. An example is the TSE’s adoption of a set of guidelines in 1994 - *Where Were the Directors? Guidelines for Improved Corporate Governance in Canada* ("Dey Report") - designed to enhance corporate governance in Canada. The role of the board under the Dey Report is defined as

... adoption of a strategic planning process; the identification of the principal risks of the corporation’s business and ensuring the implementation of appropriate systems to manage these risks; succession planning, including appointing, training and monitoring senior management; a communications policy for the corporation; and the integrity of the corporation’s internal control and management information systems.

The recommendations made by the Dey Report reflect that in the business reality

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308 *Supra* note 8.

309 *Supra* note 20 (Dey Report). The TSE corporate governance guidelines relate to a number of significant governance issue, including the proper role of the board of directors, the structure and composition of the board and its relationships with shareholders and with management. For commentary, please see Smith Lyons (Barristers & Solicitors. Patent and Trademark Agents), "Commentary: TSE Report on Corporate Governance". Online: [http://www.smithlyons.ca/comment/tse.htm](http://www.smithlyons.ca/comment/tse.htm) (date accessed: April 25, 1999); E.A. (Ward) Sellers, "Final Report of the Toronto Stock Exchange Committee on Corporate Governance" Online: [http://www.law.cornell.edu/tnj/tse.htm](http://www.law.cornell.edu/tnj/tse.htm) (date accessed: April 25, 1999); and D. W. Drinkwater & R. J. Nathan, "New Corporate Governance Disclosure Standards of Canadian Stock Exchanges Became Effective" [http://www.osler.com/Resources/BoardSum_2.html](http://www.osler.com/Resources/BoardSum_2.html) (date accessed: April 25, 1999). Since June 30, 1995, corporations listed on TSE have been required to provide their shareholders with disclosure of their corporate governance practices with reference to the guidelines of the TSE committee on Corporate Governance in Canada. On July 10, 1995, the Montreal Exchange advised listed corporations to comply with its corporate governance guidelines and disclosure requirements similar to the TSE’s.

of large publicly-held corporations, directors, other than inside directors, usually devote little time to corporate daily management and do not have sufficient information to make corporate decisions. The board therefore largely relies on the senior officers, auditors, and advisors to make decisions. Since the board usually meets a few times per year, this makes it essentially impossible for the board to exercise continuing governance. The Dey Report therefore recommended that the responsibility for the day-to-day conduct of business belongs to the management and that the CBCA should be revised to eliminate any possible misinterpretation that directors are responsible for managing the daily operation of corporations.  

Accordingly, the different business realities of widely-held public corporations, public corporations with high ownership concentration and closely held corporations invite reform of the CBCA provisions which provide uniform standards for the powers and responsibility of boards of directors of all CBCA corporations.

B Under CCL and FIIEs Laws

CCL provides the same statutory power to the board of directors of a closely-held corporation as to that of a publicly-held corporation though these provisions are listed in different chapters of the CCL. According to CCL, the board of directors of a corporation should convene shareholders’ meetings and report to the shareholders about the performance of the corporation; carry out the decisions reached by the shareholders’


312 Supra note 20 (Dey Report). See also C. Conner, Canadian Directorship Practice 1995: A New Era in Corporate Governance (Canada: The Conference Board of Canada, 1995) at 19.
meetings; *decide the corporate operation and investment plans*; formulate corporate annual financial budget plans and final accounting plans; formulate corporate profit distribution plans and a plan to satisfy any budget deficit; make needed adjustments to the amount of the registered capital; formulate plans for the issuance of corporate bonds; draft plans regarding mergers, splits or dissolution of the corporation; appoint and remove corporate management, including the general manager; and *formulate the corporate fundamental management system*.313

As listed above, most of the responsibilities that CCL vests with the board of directors involve making recommendations for the shareholders' meeting to consider in reaching decisions concerning corporate strategic matters. Therefore, the board of directors has a strong influential power in directing corporate strategic matters. As to corporate daily management and operation, they are also statutorily in the control of the board of directors. This phenomenon has a close relationship with CCL's two-tier board structure which will be addressed in 4.3.2 below.

Widely-held public corporations are rare in China.314 In terms of public corporations with high ownership concentration, as Appendix III-A, III-B and III-C show, in each case, the board of directors is not the ultimate controller. As a controlling shareholder, the state or the legal persons315 register their discretion (often through their nominees on the board) directly with the corporations.

With regard to foreign investment companies, FIEs Laws clearly recognize that the

313 Articles 46 and 112 of CCL (emphasis added).

314 It is partly because the Chinese people are used to saving money rather than making investments. Moreover, high risk in Chinese equity markets discourages people from putting money into those markets.

315 *Supra* note 108.
board of directors is the highest authority within a foreign investment company. The board of directors of a foreign investment enterprise thus in theory has the power to decide all matters of the company. However the business reality of FIEs is that investors (Chinese and foreign investors in the case of sino-foreign joint ventures or foreign investors in the case of wholly foreign enterprises) together make final decisions if they concern corporate strategic affairs.

The difference in the respective roles of the board of directors of Chinese public corporations and Canadian public corporations derives from the different corporate management models followed in the two countries. In China, the vast majority of boards of directors in theory and in practice never really make a move beyond the operational role of managing (i.e. daily management) toward the strategic role of directing. Strategic directing is an intellectual and reflective process rather than an operational one. It requires directors to consider how to allocate the basic resources of people, money, physical property, intellectual property, experience, research and development and to achieve long-term and short-term goals. During China's planning economy period, an enterprise is like a machine that runs on rails at a speed and to a timetable set by the state and so the need for strategic thinking on the part of the corporation's directors is non-existent. This is why China's socialist society equates the director with a production manager and equates the manager with a production engineer. Directors are never to engage in the strategic

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316 Article 34 of Implementation Regulations of EJV Law and Article 24 of Implementation Rules of CJV Law. WFOE Law does not provide internal management organs. It seems that to 100 per cent foreign funded companies in China, the Chinese lawmakers leave all corporate matters with the foreign investors.
planning but merely to implement it.\textsuperscript{317} Although CCL adopts the form of the corporation from capitalist countries, CCL basically adheres to the management mode left by China's planning economy and requires directors to handle corporate daily management. That is, though CCL introduced the structure of the board of directors\textsuperscript{318} in its form of corporation, the old management mode left by China's planning economy is still adopted in practice. CCL merges elements of a modern corporate structure with China's traditional enterprise management. But one cannot give direction if one is "head down", managing business day-to-day and hour-to-hour. The neglect of policy and strategic issues by directors in China, in favor of ongoing involvement in day-to-day operations, can not be addressed if China's Corporate Laws do not change the corporate internal governance structure and legal framework of property rights.

4.2.2 Duty of Directors

A Under the CBCA

On the one hand, the CBCA delegates corporate management power to the board of directors; on the other hand, it imposes fiduciary duties and duties of care, diligence and skill upon directors to ensure their accountability to the corporation.\textsuperscript{319} The fiduciary duty under the CBCA requires directors to act "honestly and in good faith with a view to the


\textsuperscript{318} In state-owned enterprises and collectively owned enterprises during China's planning economy, no structure of board of directors is provided by enterprise laws.

\textsuperscript{319} CBCA s.122 (1).
best interests of the corporation. Duties of care, diligence and skill require that directors in exercising their powers and discharging their duties should exercise the care, diligence and skill that "a reasonably prudent person would exercise in comparable circumstances". In addition to these duties under the CBCA, directors of Canadian corporations are subject to other obligations under other laws like taxation laws, environmental laws, and laws relating to occupational health and safety.

Canadian directors' personal liability in the area of environmental law, workplace safety, wages, amounts withheld for income tax purposes, etc. has already prompted concerns from the Canadian business community. It is argued that heavy personal liability for directors causes competent persons to be reluctant to sit on boards. It also results in the use of scarce corporate assets to purchase directors' and officers' insurance or in a number of cases, to create trust funds for inducing them to remain in office. The Standing Senate Committee on Banking, Trade and Commerce in Canada recommended in August 1996 (Kirby Report) that directors should be released from liability for wrongful

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320 CBCA s.122 (1) (a).

321 CBCA s.122 (1) (b).


324 Westar Mining Ltd. (Re) (1992) 14 C.B.R. (3rd) 101 at 105. "An order was made under the Companies' Creditors Arrangement Act which permitted the debtor company to maintain a $4 million trust fund to cover the liability of directors under the Employment Standards Act (B.C.) and for unpaid source deductions. The debtor company subsequently applied to pay a further $3.7 million to the Director of Employment Standards for the payment of vacation pay owing to its employees." (the application was dismissed)
payments by the corporation\textsuperscript{325}, unpaid wages\textsuperscript{326} and breaches of duty\textsuperscript{327} provided that they have exercised the degree of care, diligence and skill that reasonably prudent persons would have exercised in comparable circumstances to prevent the wrongful act.\textsuperscript{328} In order to provide directors an effective due diligence defense, the Kirby Report further recommended that reliance, in good faith, on financial statements, on the reports of experts and on information presented by officers and professionals be included as an element of the due diligence. The present CBCA does offer such a defense in certain cases.\textsuperscript{329}

Further refinement of directors' duties under the CBCA needs to be addressed by the Canadian legal community and business community together. On the one hand, directors' duties under the CBCA should ensure directors' accountability to the corporation; on the other hand, director's duties should not discourage competent persons from sitting on boards.

B Under CCL and FIEs Laws

CCL imposes fiduciary duties to the corporation on directors (as well as

\textsuperscript{325} CBCA s.118.

\textsuperscript{326} CBCA s.119.

\textsuperscript{327} CBCA s.122.

\textsuperscript{328} Supra note 279. See also Osler, Hoskin & Harcourt (Barristers & Solicitors, Patent and Trademark Agents), "Boardroom Perspectives - Corporate Governance Update: Kirby Committee Report Released", <http://www.osler.com/publications/Boardroom_Perspective/kirby.html> (date accessed: June 18, 1999).

\textsuperscript{329} CBCA s.123 (4)(b).
supervisors and officers) and subjects them to liability for breach. But the CCL does not mention the directors' duty of care, diligence and skill. In addition, fiduciary duty under the CCL, although it appears similar to the concept under the CBCA, is vague and difficult to assess. There is no legal explanation as to what "faithfully perform" means. Moreover, the limitation on judges' function in explaining laws under the current Chinese legal system leaves the implementation of directors' duty in an uncertain state. With regard to FIEs Laws, no provisions deal with directors' duty.

In addition, a distinctive feature of CCL regarding directors' duty is that CCL provides detailed administrative sanctions and criminal liabilities for directors (as well as supervisors and managers) if they violate rules, duties or requirements under CCL. Administrative sanctions apply to directors who represent the state/public interests. The heavy penalties provided by CCL (and other laws like criminal law) constitute a deterrent against potential illegal corporate decisions. But the negative tone set by CCL, at the same time, may discourage good faith risk-taking activities in China.

4.2.3 Chair of the Board

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330 Articles 59, 123 and 128 of CCL provide that the directors, supervisors, and managers should comply with the articles of association, faithfully perform their duties and maintain the interests of the corporation and should not take advantage of their position, functions and powers in the corporation to seek personal gains.

331 But since adoption of CCL, the provisions of CCL also applying to FIEs determine that directors of sino-foreign joint ventures or wholly foreign owned corporations are subject to the same fiduciary duties as provided by the CCL.

332 "Administrative sanctions" in Chinese is Xing Zhen Chu Fa.

333 See chapter 10 of CCL.

334 See section 3 of chapter 3 of Criminal Law of the People's Republic of China (Adopted by the Second Session of the Fifth National People's Congress on July 1, 1979 and amended by the Fifth Session of the Eighth National People's Congress on March 14, 1997).
The above comparative examination of the power of the board of directors in connection with the direction of corporate business and the duties of directors in Canada and China indicates that though China introduced the structure of board of directors in the CCL and FIEs Laws, China's Corporate Laws have not, however, vested in the board of directors the same broad decision-making power as the CBCA does. Moreover, administrative sanction, a type of liability for the head of an enterprise335 during China's planning economy, remains in the CCL. The distinctive provisions for personal liabilities of the Chair of the board (i.e. the legal representative, Fa Ding Dai Biao Ren, see 4.2.3 B below) under the Chinese laws is an interesting part of China's Corporate Laws and reflects a different corporate internal control practice in China.

A In Canada

The power of managing the business of the corporation is vested with the board of directors. The chair of the board is not given any special managerial power by the CBCA. The chair is considered an officer of a corporation336 and his or her duties usually include presiding at meetings of the board of directors and possibly of the shareholders and such other functions and powers as may from time to time be assigned to him/her by the board

For an English version, please see Online: Maryland University School of Law, ChinaLaw Website: <http://www.qis.net/chinalaw/lawtran1.htm> (date accessed July 3, 1999).

335 "Head of an enterprise" in China is often called "Chang Zhang".

See also, J.H. Jenkins, Conduct of Canadian Meetings (Toronto: Butterworths, 1983) at 15.
of directors.\textsuperscript{337} The chair is usually a director and, if that is the case, of course the duties of directors provided by the CBCA would also be applicable to the chair.

B In China

It is provided under CCL and FIEs Laws that the chair of the board is the legal representative (i.e. Fa Ding Dai Biao Ren) of the corporation.\textsuperscript{338} The legal representative of a corporation under Chinese laws is the person who takes charge of and exercises authority on behalf of the corporation according to the constitutional documentation of the corporation.\textsuperscript{339} The chair's statutory responsibility includes taking charge of convening the shareholders' meetings and ensuring that corporate business is properly conducted. In addition, the chair has to convene and preside over the meetings of the board of directors, examine the implementation of board resolutions; and sign the shares and bonds of the corporation.\textsuperscript{340} In practice, as long as actions of the chair are in relation to the business of

\textsuperscript{337} \textit{Ibid.} (H. Sutherland) at 273.

\textsuperscript{338} Articles 45 (for closely-held corporations) and 113 (for public corporations) of CCL. Article 37 of the Implementation Regulations of EJV Law and Article 31 of Implementation Rules of CJV Law.

\textsuperscript{339} Article 38 of the \textit{General Principles of Civil Law of the People's Republic of China} (adopted at the Fourth Session of the Sixth National People's Congress and effective as of January 1, 1987). An explanation from Supreme People's Court further defined the term "legal representative" (Fa ding dai biao ren) in detail:

a. chief executives such as the president or manager or chairman of the board of directors;
b. where the chief executive’s position is vacant, the vice president or vice chairman or vice manager as the case may be who is actually responsible for the administrative work of the company;
c. where the above positions are all vacant, the persons that are actually in charge of a legal person.

Please see H. R. Zheng, \textit{China's Civil and Commercial Law} (Hong Kong: Butterworths, 1988) at 312.

\textsuperscript{340} Article 114 of CCL.
the corporation, such actions are deemed corporate behaviors. By introducing the concept of legal representative, China's Corporate Laws personalize corporations.

Like an agent under Canadian corporate law, the legal representative in China (i.e. the chair of the board) is legally authorized to act on behalf of the corporation. But the legal representative is subject to greater personal risk than an agent in Canada typically is. In addition to fiduciary duty, Chinese laws impose upon the chair various civil liabilities, administrative sanctions (like warnings, reprimands, and probation) and fines in case the corporation violates laws.  

The administrative liability imposed by Chinese laws on a chairman reflects vestiges of the enterprise management mode that prevailed under the planning economy. During the planning economy period, the person-in-charge of a state-owned enterprise usually was a governmental officer who acted as the state's representative in managing the enterprise. Imposing administrative sanctions on persons who are in charge of state assets was one of the ways used to deter the potential abuse of managerial power since a government officer normally would not abuse enterprise managerial power at the risk of his/her political status. The additional administrative liability for the chairman to some


342 Refer to Articles 38, 43,49 and 110 of the General Principles of Civil Law of the People's Republic of China (adopted at the Fourth Session of the Sixth National People's Congress and effective as of January 1, 1987). It provides in detail the liability that a legal representative has for a legal entity.

343 Articles 43 and 49 of General Principles of Civil Law of the People's Republic of China (Adopted at the Fourth Session of the Sixth National People's Congress, promulgated by Order No. 37 of the President of the People's Republic of China on April 12, 1986, and effective as of January 1, 1987) English version is available: Maryland University School of Law, ChinaLaw Website: <http://www.qis.net/chinalaw/lawtran.htm> (date accessed: June 3, 1999).
Practically, because the liabilities of the chairman are so severe, foreign investors in a sino-foreign joint venture usually leave the position to Chinese parties while a foreign investor will hold the position of general manager (corresponding to the position of chief executive officer in Canada).
extent reflects China's incomplete economic reform and the socialist roots of its managerial culture.

4.3 Outside Directors in Canada and Supervisory Boards in China

Canadian corporations employ a single tier board structure while in China, except in the case of FIEs, corporations adopt a two-tier board structure, one for management and the other for supervision. The monitoring function in the Canadian single tier board is mainly exercised by the outside directors.

4.3.1 Outside Directors under the CBCA

A The Function

The CBCA provides that, in the case of a distributing corporation, at least two directors who are not officers or employees of the corporation or its affiliates should sit on the board. These directors are referred to as "outside directors".

The primary reason behind this provision is that inside directors (i.e. directors who are employees or officers of the corporation or its affiliates) are potentially unable to effectively and objectively evaluate the performance of managers or officers because such

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344 It is noted that for closely-held corporations in China, the two-tier structure is not mandatory. See Infra note 357.

345 It is noted that strictly speaking in theory, all directors should be performing the management monitoring function, not simply the outside directors.

346 CBCA s. 102 (2).
an evaluation could jeopardize the employee-directors' own career progress within the corporation. Therefore, the main purpose of involving outside directors is to effectively and objectively monitor corporate management and provide a check against abuse of managerial power by corporate decision-makers. Thus, outside directors may perform a discipline function over the management team. In addition, outside directors may play a role as advisors or counsel to corporate management.

B The Reality

In reality, the efficiency of outside directors is doubtful given the high number of overlapping directorships in Canada. The concern over such director ties has focused on their anti-competitive potential in cases where the corporations on whose boards the directors sit are competing companies. That is, if a director is on the board of directors

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350 The requirement of appearance and presentation before the outside directors serves as some sort of discipline for management officers. See supra note 11 at 40.

351 Since outside directors normally are top managers in their industries, their general or specific experiences can provide inside directors and managerial officers "additional windows to the outside world". See note 8 at 40, supra.


Theoretically, interlocking directors enable corporations to obtain better intelligence about their deficiencies in their transactions with other corporations. Horizontal interlocks help corporations to cope with the competitive uncertainties that prevail in oligopolistic industries. Vertical interlocks contribute to superior effectiveness by circumventing the situation that one corporation in a market is comparatively better informed than its competitors about the market's parameters.

It is not known, however, how often directors actually do or can sit on the boards of competitors.
of two or more competing corporations, the interlocking director may use one corporation as an instrument of command and as a means of communications with other corporations on whose boards he or she also sits. Such interlocking directorships exacerbate the potential conflict of duties and interests to which all directors may be subject. Over a century ago, Lord Cransworth pointed out the broad equitable principle relating to such conflicts as follows.353

[N]o one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting or which possibly may conflict, with the interests of those whom he is bound to protect.

Moreover, a study conducted by Lin shows that requiring outside directors on a board does not always bring good corporate performance.354 Thus, there has been a longstanding controversy in the business and legal communities in North America in respect of the effectiveness of outside directors.355 That controversy might explain Parliament's cautious attitude toward amendment of the CBCA in this respect.356

C Improvement


354 Supra note 347 at 966.

355 The effectiveness of outside directors is a controversial issue. Two opposing schools of thought exist, "managerial hegemony" and "effective monitor". According to the theory of "managerial hegemony", the board is dominated by management because of the biases in the nomination and selection processes of the outside directors, the constraints on outside directors’ ability to monitor or discipline the management, and the weak incentives of the outside directors to monitor. According to the theory of "effective monitor", outside directors are motivated to protect shareholders’ interests and usually they are expert in decision making because they value their reputation, or have a direct incentive to monitor if they have equity ownership, or business ties with the corporation. See supra note 347.

356 It is acknowledged that whether or not outside directors are necessarily a good thing is a matter of some controversy. The answer may vary from case to case.
The CBCA-style definition of outside director has been criticized by the Toronto Stock Exchange Committee on Corporate Governance (TSE Committee) in its report regarding improved corporate governance in Canada (Dey Report).\textsuperscript{357} The TSE Committee goes beyond the traditional definition of directors as inside or outside directors and proposes a concept of "unrelated director".\textsuperscript{358} The major differences between an outside director and an unrelated director are: first, an employee or representative from an investment bank, law firm or accounting firm which provides services to the corporation may be considered related under the Dey Report, while according to the CBCA's definition such person is not related; and second, the Dey Report suggests that, in addition to a majority of unrelated directors, a board should also include individuals who are not aligned with either the corporation or a significant shareholder.\textsuperscript{359} In this regard, the TSE Committee's recommendation is sensitive to the interests of minority shareholders and addresses the reality of high ownership concentration in Canada.

It seems that whether the CBCA will follow the recommendation of the TSE Committee on "unrelated directors" largely depends on whether the Canadian legal

\textsuperscript{357} Supra note 20.

\textsuperscript{358} According to the Dey Report (supra note 20), an unrelated director is "a director who is independent of management and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the directors' ability to act with a view to the best interests of the corporation, other than interests and relationships arising from shareholding.... If the corporation has a significant shareholder, in addition to a majority of unrelated directors, the board should include a number of directors who do not have interests in or relationships with either the corporation or the significant shareholder and which fairly reflects the investment in the corporation by shareholders other than the significant shareholders. A corporation with a significant shareholder should have the appropriate number of directors which are not related to either the corporation or the significant shareholder."

Paragraph 5.7 and 5.8 of Dey Report.

community and commercial community can reach a consensus in response to the Canadian commercial reality.

4.3.2 Supervisory Board under CCL

Comparable to the outside directors under the CBCA in China is CCL's supervisory board.

A The Function

CCL provides that corporations should have a supervisory board composed of no less than three people including representatives of shareholders and an appropriate proportion of the workers. Directors, managers, staff in charge of financial affairs of the corporation and state servants cannot act as supervisors. The proportion of the workers who are on the board is determined by the articles of association of the corporation.

The major function of the supervisory board is to monitor the interests of the

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360 FIEs are not required to have supervisors or a supervisory board. Public corporations are required to set up a supervisory board. In closely held corporations, a supervisory board is required if the corporation is a large. Please see Articles 52 and 124 of CCL.

361 Small closely-held corporations can have one or two supervisors instead of a supervisory board. Article 52 of CCL. However, CCL does not provide its definition of "small size".

362 Articles 52 and 124 of CCL.

363 Articles 52 and 58 of CCL.

364 Article 124 of CCL.
In exercising such monitoring function, supervisors have the right to examine the financial affairs of the corporation; monitor the performance of the directors and managers; demand the directors and managers correct their acts in any case where their behaviors damage the interests of the corporation; propose interim shareholders' meetings; and other rights if provided by the articles of association of the corporation. In addition, supervisors should attend the meetings of the board of directors with non-voting status.

Introduction of supervisory boards under CCL follows Continental practice and in particular the practice in West Germany where the two-tier board structure has been highly developed. But CCL did not completely follow the German model. The two-tier board structure adopted by German companies requires a supervisory board to control the basic business policy of a corporation and a management board to manage corporate affairs. In 1976, pressured by trade unions, worker representation on the boards of larger German companies was increased to 50 per cent. The German example was widely followed by Holland, Sweden, and France. The provisions regarding the supervisory board under CCL, however, does not give the supervisory board the power to control

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365 Supra note 86 at 214.

366 Articles 54 and 126 of CCL. It is provided under Article 53 and Article 125 of CCL that the term of the office of the supervisor should be three years. Consecutive terms are allowed if the supervisor reelected upon expiration of the term.


368 Supra note 34 at 71.
fundamental business policy of a corporation nor does it provide a specific compulsory ratio for worker representation on the supervisory board.

B The Reality

The provisions regarding the rights and responsibilities of the supervisory board under CCL do not result in supervisors' active involvement in corporate affairs. A number of reasons account for the passive role of corporate supervisors in China. First, representatives of workers have employment relationships with the corporation. Practically it is impossible for worker representatives to monitor directors or managers given their concerns for their own job security. Second, the independent status of the supervisory board is problematic since the supervisors are employees or shareholders of the corporation. Third, the efficiency of involving workers and shareholders as supervisors is doubtful since most of them lack the time, expertise, and training necessary to evaluate corporate managers. Fourth, CCL does not provide that the supervisory board has the right to elect or remove directors, or to take actions on behalf of the corporation against management. The right of the supervisory board to demand that directors and managers correct their misbehaviors does not have any effect due to the absence of any effective legal remedy. That is, if directors or managers fail to correct their acts in accordance with the supervisors' advice or if the board ignores a proposal from the supervisors to convene the interim shareholders' meetings, there is really no legal recourse available to the supervisors. Fifth, in cases where the state is a majority shareholder, it is observed that the supervisors lack incentive to monitor the management team since such supervisors do not have equity ownership in the corporation nor does the corporation
provide any incentive devices. Sixth, in reality, most supervisors are working part time, have no office facilities in the corporation and generally follow the instructions of the board of directors or the general manager of the corporation. It is said that the working reports of some supervisory boards are dictated by the chairman of the board or the general manager.

C Improvement

The monitoring function of the Chinese supervisory board will not be effective unless supervisors are vested with substantial powers to act as a check against managers and directors. The issues listed in the preceding paragraph must be addressed if the supervisory board is expected to play an active role in monitoring corporate decision-makers in China. Only when the business community and/or legal community in China is aware of the defects contained in the existing supervisory board structure under the CCL can further improvement of China’s two-tier board structure be expected.

4.3.3 Recommendations

As has been seen, the one-tier board structure adopted by the CBCA with outside directors performing the function of oversight of corporate affairs is the same board structure found in US corporations. In China, however, except in the case of foreign

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370 Ibid. at 33.
investment enterprises, corporations adopt a two-tier board system, one for management and the other for supervision, a system similar to Germany’s two-tier board system.371

A board with outside directors performing oversight of corporate management has certain advantages. First, outside directors may objectively analyze corporate performance since outsiders will be less dependent on the inside directors (who are usually members of senior management) and less influenced by the presence of senior management.372 Second, outside directors tend to provide neutral counsel and advice. This is based on the assumption that inside directors are committed to company tradition and old ideas. Through the influence of and the perspective provided by outside directors, corporate management can adapt to technological advances, competition, and economic change as well. On the other hand, it has been argued by some that outside directors cannot actually perform such effective oversight at all given that outside directors devote little time and energy to their monitoring duties. They may not have sufficient knowledge to effectively oversee management since they do not have access to the same detailed corporate information as managers have.373

However, theoretically, a number of reasons support a split of the board into a managing board and an oversight or supervisory board. First, with a clear personal and institutional split between management and monitors, a distinct distribution of

371 The hostile British reaction to German’s two-tier structure helps to explain why Canadian corporate law did not adopt the concept of the supervisory board. The Engineering Employers’ Federation in London stated that, “the infliction of such a theory would be destructive of the general efficient operation and wealth-creating activity of private enterprise in Britain.” Cited by L. C. B. Gower, Gower’s Principles of Modern Company Law, 4th ed. (London, Stevens & Sons, 1979) at 71 from Employee Participation (1974) at 3.

372 Supra note 19 at 110.

responsibilities and powers is created which, in turn, may promote efficiency.\textsuperscript{374} Second, such an institutional separation allows the board of directors to act more independently without being influenced by senior managerial officers (e.g. the Chief Executive Officer). For instance, the management and monitoring divisions will separately prepare the board meeting agenda to discharge their respective responsibilities. Therefore, the two-tier board system provides the basis for an explicit functional specialization of monitors and managers.

However, the two-tier board system is not without weakness in practice. First, because of the split between management and supervision, the members of the supervisory board, relieved of operational responsibilities and focused on fulfilling their monitoring duties, may arguably have less time to invest and have less corporate information. The split of management functions into two boards may itself have an impact on the corporate data flow. Monitoring corporate management, especially in a large public corporation, requires a considerable amount of time, information and commitment. Part-time outsiders, half-hearted in commitment, and with severe limits on their access to data do not necessarily enhance the monitoring function.\textsuperscript{375} Second, the legislative concept of a two-tier structure, which creates an independent monitoring organ to control the executive management, is difficult to convert into corporate reality since a mandatory two-tier structure in public corporations is not able to break up the "natural" internal power circles of large organizations.\textsuperscript{376}

No matter whether a corporation has a single tier board structure or a two-tier

\textsuperscript{374} Ibid. at 464.

\textsuperscript{375} Supra note 373 at 465.

\textsuperscript{376} Ibid. at 466 - 467.
board structure, the function of monitoring (as a checking and balancing power) should be exercised independently from the management. The principal objective of a corporation is to pursue corporate profit and enhance shareholder gain through its business activities.\textsuperscript{377} In achieving this objective, the board's role requires it to be accountable for the success of the corporation by taking responsibility for management.\textsuperscript{378} In this sense, it is advisable to split the function of monitoring and management within a company regardless of whether it has a single tier board or a two-tier board structure. There is no universal structural model for achieving an optimal division of these two functions since every country has its unique statutory and cultural traditions and its own business reality.

Summary

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\textsuperscript{377} Ever since the appearance of the modern corporation, there has been a long-term controversy relating to the proper objective of the corporations. Though the early public corporations were set up for public purposes (e.g. toll bridges), the capitalist theory of maximizing capitalists' wealth led to corporations organized for the enrichment of the corporations. As the Nobel Prize-winning economist, Milton Friedman stated, "A single, objective goal like profit maximization is far more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interests. It is easier, for example, to tell if a corporate manager is doing what she is supposed to do than to tell if a university president is doing what she is supposed to do." (cited by A. A. Sommer Jr. "It All Comes Down to Money, Face it: A Board's Main Goal is Corporate Profits" online: ABA Section of Business Law, Business Law Today (January/February 1999 <http://www.abanet.org/buslaw/8-3money.html> (date accessed June 14, 1999).

The Organization for Economic Co-operation and Development (OECD) in its April 1998 Report states that "Most industrialized societies recognize that generating long-term economic profit (a measure based on net revenues that takes into account the cost of capital) is the corporation's primary objective. In the long run, the generation of economic profit to enhance shareholder value, through the pursuit of sustained competitive advantage, is necessary to attract the capital required for prudent growth and perpetuation." \textit{Supra} note 18 at 27.

Within the academic area, professor M. M. Blair in her \textit{Ownership and Control: Rethinking Corporate Governance for the 21st Century} (Washington D.C.: Brookings Institute, 1995) argues that the corporation ought to take into account the interests of employees, suppliers, customers, communities, long-term interests of shareholders as well as short-term interests, the interests of the state and so on.

\textsuperscript{378} \textit{Supra} note 22 at 28. Citing Report of the National Association of Corporate Directors Commission on Director Professionalism at 1 (November 1996).}
The comparative examination of the power and duties of the board of directors, the role of the chair of the board and the monitoring function performed by boards under the CBCA and China's Corporate Laws as well as in the business reality of Canada and China reveals that, though China introduced the structure of the board of directors based on models used in capitalist countries, the traditional management model left by China's planning economy is still codified under China's Corporate Laws. Rather than granting the board of directors actual decision-making power, CCL vests the board with a high degree of influencing power in corporate strategic matters. Compared with Canadian law, China's Corporate Laws have not seriously addressed the issue of duties of the directors. But the distinctive provisions dealing with personal liabilities of the chair of the board contained in China's Corporate Laws reflect vestiges of the enterprise management mode under China's planning economy. As to the monitoring function of the board, the comparative study indicates that China's two-tier board structure under the CCL does not seem to enhance corporate efficiency to any greater degree than Canada's single tier board structure.

This comparative examination of the role of the board in corporate internal control further indicates that, adhering to a socialist regime, China's Corporate Laws try to meld the western management mode with the enterprise management mode originally developed under a planning economy.

4.4 Managerial Officers - Control through Managerial Expertise

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379 Note that there was no structure like the board of directors in state-owned or collectively owned enterprises.
There is no general definition of the term "officer" under the CBCA. Officers are those people designated as such by the directors.

The role of managerial officers in corporate operations under the CBCA and China's Corporate Laws is often not paid much attention in the statutes themselves. Practically speaking, managerial officers in the largest and most financially important corporations in Canada enjoy virtually free reign in determining the corporation's destiny.

4.4.1 Power of Officers under the CBCA and in Reality

Although the board of directors is vested with the statutory right to manage corporations according to the CBCA, the business reality of modern corporations is that day-to-day management has been delegated, to a substantial extent, by the board of directors to managerial officers, particularly in large widely held public corporations. But it should be noted that under the CBCA, not all the powers of the board can be delegated to the officers. The powers that cannot be delegated relate to fundamental corporate changes and major business decisions, such as making changes to the by-laws (which are subject to shareholders' approval), approving financial statements, a management proxy circular, a take-over bid circular or directors' circular; issuing securities (except on terms already approved by the board); declaring dividends; and purchasing or redeeming shares of the corporation.

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380 The extent of such delegation varies depending on the size and circumstances of the corporations. The board of large corporations may delegate more authority and responsibility to the management. The board of small or closely-held corporations may become involved with more detailed business of the corporation.

381 CBCA s.103(1).

382 CBCA s.115(3).
The reason directors delegate daily managerial power to the full-time officers is linked to the officers' professional managerial skills and knowledge about the corporation, and to the fact that the officers work full time for the corporation, while the directors do not. Corporate officers' powers may also be expanded as a result of the workings of the proxy system. The proxy system can either be employed by dissenting minority shareholders or by the management for accumulating votes. Most shareholders of large public corporations do not have an interest in attending and voting at the shareholders' general meetings. The management thus seeks to have a management nominee appointed as the shareholder's proxy with all proxy solicitation expenses borne by the corporation. The result usually is that the passive majority of shareholders simply endorse the doctrines of management. This creates the opportunity for management (that is, senior corporate officers) to control the corporation's strategic business.

Therefore, in a Canadian widely held public corporation, the managerial expertise of corporate officers allows them to control corporate daily management. Further, the existence of a significant number of passive shareholders and a management controlled proxy system permits this same group to direct corporate strategic business. Accordingly, the senior managerial officers are more likely to be the ultimate corporate controllers of a widely held public corporation. Appendix II - A illustrates this business reality.

It is found that in a high ownership concentration public corporation in Canada, the presence of a single shareholder or a small group of shareholders (exercising either legal or effective control) and the fact that such "controlling shareholders" have contributed substantial capital to the corporation mean that their concerns over the

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383 CBCA s.149(1).
corporate business are more likely to be addressed by corporate managers at least with respect to strategic management of the corporation. It is even possible that the controlling single or group of shareholders are also managers. Appendix II - B illustrates this business reality.

In terms of closely-held corporations in Canada, since managerial officers are often also its shareholders, shareholder-managers are the ultimate controllers of these corporations as well. Please see Appendix II - C.

In recognition of managerial officers' power in managing corporate matters, the CBCA extends fiduciary duties to officers. Therefore, the corporate officers function as agents of the corporation and, at least at the level of senior management, owe a fiduciary obligation and duty of care, diligence and skill to the corporation and are treated in the same way as directors in this respect.384

4.4.2 Powers of Officers under CCL and FIEs Laws and in Reality

CCL provides the same powers to officers of closely-held corporations and publicly-held corporations.385 In addition to the right to attend the board meetings as non-voting attendants, and other powers stipulated by the articles of association of the corporation or delegated by the board of directors to the officers, CCL provides in detail that managers in Chinese corporations have to be in charge of the daily operation of the corporation, implement board resolutions, organize the implementation of the annual

384 CBCA s.122 (1).
385 Articles 50 and 119 of CCL.
business plans and investment plans of the corporation; formulate plans for establishment of the internal management organs of the corporation; formulate the basic management system of the corporation; formulate specific rules and regulations of the corporation; recommend the appointment or dismissal of the deputy managers and of persons in charge of the financial affairs of the corporation; and appoint or dismiss management personnel other than those to be appointed or dismissed by the board of directors. It seems that CCL provides a high degree of influencing power to managers and expects them to give suggestions to the board in respect of daily corporate management. In the meantime, CCL requires the managers to be responsible for daily corporate operations.

As to managers in foreign investment companies in China, FIES Laws provide that the general manager and vice general managers together are responsible for the day-to-day management of FIEs. But unlike CCL, the FIES Laws do not detail the responsibilities of the managers.\(^{386}\)

In each of the three types of public corporations in China, as shown in Appendix III-A, B, and C, in general, managerial officers are not ultimate controllers. Instead, their principal role is to implement corporate decisions.

In terms of closely held corporations in China, such as foreign investment companies, as demonstrated in Appendix III - D, only the general manager (or vice general managers) will be in charge of corporate daily management;\(^{387}\) other junior managers will implement management decisions.

Fama and Jensen have defined the decision-making process in terms of four

\(^{386}\) Article 38 of Implementation Rules of EJV Law and Article 32 of Implementation Rules of CJV Law.

\(^{387}\) The role of general managers and vice general managers will be addressed in 4.4.3 below.
steps.\textsuperscript{388}

Institution - generation of proposals for resource utilization and structuring of contracts;
Ratification - choice of the decision initiatives to be implemented;
Implementation - execution of ratified decisions; and
Monitoring - measurement of the performance of decision agents and implementation rewards.

Managers in Chinese public corporations and closely-held corporations (except the general manager or vice general manager in FIEs) are handling the implementation process.

With regard to the duties of managerial officers, they are subject to the same fiduciary obligations as are the directors under CCL.\textsuperscript{389}

4.4.3 Chief Executive Officer in Canada and General Manager in China

Managerial officers are able to influence the board through insider directors sitting on the board. The influence of managerial officers can reach its pinnacle when the corporation's chief executive officer (in the case of Canada) or general manager (in the case of China) also takes the position of chair of the board of directors. It has been found that in Canada the combination of chief executive officer and chair of the board of directors is more likely to be found in small corporations than large corporations.\textsuperscript{390}

Overall, 34.5 per cent of Canadian corporations have the chief executive officer as the

\textsuperscript{388} E.F. Fama & M.C. Jensen, "Separation of Ownership and Control" (1983) 26 J. L. & Econ. 301 at 303.

\textsuperscript{389} See 4.2.2.B.

\textsuperscript{390} Supra note 131 at 235.

One interesting phenomenon is that corporations with a combined CEO and chairmen have a relatively large percentage of inside directors, while corporations with independent chairmen are found to have a relatively low percentage of inside directors.
chair of the board. In over 83 per cent of Canadian corporations, the chief executive officer is also a member of the corporation's board of directors.\footnote{Supra note 127 at 13.} The combination of general manager and chairman in foreign investment companies in China is rare.\footnote{No detailed data, however, is available.} The reason is that there are greater risks associated with the position of chairman (i.e. legal representative) in China, as has already been addressed in 4.2.3 B. However, the combination of general manager and director is the norm in Chinese corporations.

There have been suggestions in Canada to split the positions of chief executive officer and chairman of the board.\footnote{Osler, Hoskin & Harcourt (Barristers & Solicitors, Patent and Trademark Agents) Boardroom Perspectives: Corporate Governance Update, "Chair and CEO Should the Roles be Split?" <http://www.osler.com/publications/Boardroom_Perspective/govfeb97_2.html (date accessed: July 15, 1999).} The rationale behind such proposals is relatively straightforward: the board of directors can only effectively exercise the function of monitoring senior management to the extent that it is independent from management. It would seem, however, that the benefit of splitting the positions of chief executive officer and chairman of the board would vary from case to case. Currently there is no uniform answer to the question of whether there two positions should or should not be held by the same person.

4.4.4 Summary

The role of managerial officers in corporations varies with different types of corporations in both Canada and China. The comparative examination of managerial
officers' powers of decision-making in Canadian and Chinese corporations demonstrates that in Canada, the senior managerial officer (such as the Chief Executive Officer) very likely wields ultimate decision power in widely-held public corporations and shareholder-managers may be corporate controllers in public corporations with high ownership concentration and in closely-held corporations. In China, managerial officers in public corporations more often play a role confined to implementing corporate management decisions and the general manager in closely-held corporations is the decision-maker in terms of corporate daily management.

The relatively modest role of managerial officers in China is closely connected with the enterprise management mode that existed under the planning economy in which managers were not called upon to decide enterprise strategy or daily planning but rather were expected simply to carry out state plans.

The high degree of influencing power granted to corporate managers of Chinese public corporations represents a half-way management model between Canadian managerial discretion in the direction of corporate business and the Chinese socialist management model which does not require managers to make management decisions.

4.5 Employees - Control through Collective Influence

Employees' influence on corporate control can be effected in two ways. One is that employees can become shareholders of a corporation by purchasing shares of the corporation. This point has been addressed in 4.1.3 above. The other way in which the employees can exert their influence on corporate decision making is through unions or through their representatives on the supervisory board (in the case of China). The second
point is to be examined in this section.

4.5.1 Under the CBCA

The fact that workers form an integral part of a corporation is essentially ignored by Canadian corporate laws. The CBCA is silent on the issue of employee participation in the corporate decision-making process. Canadian law-makers seem to be reluctant to provide for workers' participation in corporate management.

The reason for this reluctance to provide for employee participation by statute might be related to the relatively low level of union involvement historically in corporate decision making in Canada. In 1994, Dr. Wagar conducted a survey of labor unions across Canada examining their involvement in employer decision-making and strategy, human resource policies, and the labor-management climate. The survey indicated that "there was strong evidence that organizations were not integrating quality management with a culture focusing on employee participation." The survey demonstrated relatively low support for the statements that employee participation in strategic management decisions is encouraged and that top management was committed to employee involvement. Therefore, neither under Canadian corporate law nor in business reality do employees, as a collective, have a substantial power of influence over corporate management.

394 T. H. Wagar, Labor-Management Relations in Canada: A Survey of Union Officers (Canada: Industrial Relations Center, Queen's University. 1996) at 1.

395 Ibid. at 4.
From a legal theoretic point of view in Canada, the relationship between employees and the corporations that employ them is governed by the employment contract, rather than corporate law. But the reality is that the true relationship between employees and their corporate employers goes beyond contractual relationships. Employees depend upon their employers for their livelihood, and the existence and success of the corporation, in turn, depends upon their labor. They are, in fact, "members of the company for which they work to a far greater extent than are the shareholders whom the law persists in regarding as its proprietors." 396

4.5.2 Under CCL

The right of employees to be represented on the supervisory board and to participate in corporate decision making is codified in the CCL.397 Although workers do not have the right to vote at board meetings, it is clearly provided by the CCL that when a corporation decides issues relating to salaries, welfare, working safety, working conditions, labor insurance and so on, the corporation should solicit in advance the

396 Supra 34 at 10-11.
Professor C.C. Nicholls of Faculty of Law of Dalhousie University has further suggested that there is a fundamental ideological issue here. In Canada, it seems that the only proprietary right that has thus far been clearly sanctioned by the legislators and the courts is an ownership right flowing from acquisition of property with capital. Canadians lawmakers do not get appear to recognize proprietary or quasi-proprietary rights flowing from the contribution of labor, rather than capital, to an enterprise.

397 The dual board style and labor participation in corporate decision making in China follow the model of Germany. However, they are different from the German system. According to Codetermination Act of 1951, one half of the directors on the corporate board in the coal and steel industries is to be elected as employee representatives. The Works Constitution Act of 1952, which applies to all other industries requires that one-third of the directors be employee representatives. See K. J. Hopt, "New Ways in Corporate Governance: European Experiments with Labor Representation on Corporate Boards" (1984) 82 Mich. L. Rev. 1338 at 1350, and J. P. Charkham, Keeping Good Company: A Study of Corporate Governance in Five Countries (United States: Oxford University Press Inc. N.Y., 1994) at 15.
opinions of the union and workers. The union and representatives of workers\textsuperscript{398} should be invited to attend relevant meetings as non-voting participants.\textsuperscript{399} When management studies and decides "major corporate issues" and formulates "important corporate rules", opinions and suggestions from the union and workers should be heard.\textsuperscript{400} CCL however does not provide what constitutes "major corporate issues" and "important corporate rules". It is observed that, in reality, only those matters relating to job security, salaries, welfare, and working conditions are to be co-determined by the workers (through their union or representatives of workers\textsuperscript{401}) and the board.

4.5.3 Under FIEs Laws

It is provided under FIEs Laws that while the board of directors decides issues relating to rewarding or disciplining employees, the salary system, welfare,\textsuperscript{402} labor protection and insurance, representatives from the union should attend the relevant meetings without voting rights to express the concerns and opinions of the workers.\textsuperscript{403}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{398} In China, the union is an organization organized according to laws and regulations relating to unions and participated in by labor. See Article 7 of \textit{Labor Law of the People's Republic of China} (effective on January 1, 1995). The fund contributed by corporations and the function of unions are governed by the \textit{Trade Union Law of the People's Republic of China}. While representatives of workers are elected by all workers of an enterprise according to corporate internal rules. Such election may or may not be held regularly. Worker representatives once elected can negotiate with management any matters that proposed by all workers' meetings.
\item \textsuperscript{399} Article 55 (for closely-held corporations) and Article 121 (for publicly-held corporations) of CCL.
\item \textsuperscript{400} Article 56 (for closely-held corporations) and Article 122 (for publicly-held corporations) of CCL.
\item \textsuperscript{401} \textit{Supra} note 398.
\item \textsuperscript{402} "Welfare" is a general term under China's Corporate Laws. It may include medical welfare, housing subsidy, and/or children's education subsidy, etc.
\item \textsuperscript{403} For example. Article 98 of the Implementing Regulations for the Law of the People's Republic of China on Sino-foreign Equity Joint Venture Enterprises (Zhong Hua Ren Min Gong He Guo Zhong Wai
Generally, employee's collective influences on the corporate management of both FIEs and corporations under China's Corporate Laws are modest. These influences are usually related to employees' interests (like salary, welfare, labor protection, etc.) in the corporations. Theoretically, employees in CCL corporations have greater influence over the management than do employees of FIEs. The reasons are connected, first, with the very fact that FIEs do not have supervisory boards, and thus employees of FIEs lack an institutional check on the power of the board of directors, that employees of CCL corporations enjoy, and second, with the fact that Chinese employees can never be owners of FIEs under current FIEs Laws.

4.5.4 A Comparative Analysis

The model that the CBCA adopts, with essentially no labor involvement in the corporate decision-making process, appears to reflect an underlying philosophy that the involvement of workers in corporate affairs would likely jeopardize the long-term future of the business. On this view, labor unions and management should be separated in

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He Zi Jing Ying Qi Ye Fa Shi Shi Tiao Li (promulgated by the State Council on September 20, 1983 and amended by the State Council on January 15, 1986 and on December 21, 1987) and Article 71 of the Implementing Rules for the People's Republic of China on Wholly Foreign-owned Enterprises (Approved by the State Council on October 28, 1990, promulgated by the Ministry of Foreign Economic Relations and Trade on December 12, 1990 and effective from December 12, 1990).

It is provided under the FIEs Laws that in order to ensure the union has funds to operate, FIEs must allocate certain funds to the union each month. Article 99 of Implementation Regulations of EIV Law. Article 72 of Implementation Rules of WFOE Law.

Neither EJV Law nor CJV Law provides that Chinese individuals may be a party to sino-foreign equity joint ventures or sino-foreign cooperative joint ventures. Article 1 of EJV Law and Article 1 of CJV Law.

A broad issue arises from this statement. That is, whether or not it is proper for the board of directors to expressly consider the interests of employees (among others) in making decisions in the best interests
order to maintain the integrity of the collective bargaining process. The rights of employees and managerial discretion should be preserved by arm's length negotiation confined to the terms of employment.

The model that CCL and FIEs Laws adopt including labor participation in the corporate decision-making process tends to ensure that the interests of employees are taken into account in management of the corporations and that employees share some responsibility in corporate decision making. In the eyes of Chinese law-makers, the interests of workers in the corporation, though different from the interests of shareholders, are as important as the interests of investors. The Chinese labor market is less liquid than the capital markets, so that switching jobs is not as easy as selling stock (especially in the case of those workers who have developed firm specific skills for whom the chance of mobility in the labor market is slim). It is also hoped that such a regime can, to some extent, curb managerial dishonesty and diminish disharmony between labor and management. It is expected that, through labor representation, employees will become more productive and have a strong sense of commitment to their corporations.

The provision of labor representation under CCL and FIE Laws is deeply rooted in

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407 Since the labor market is not as liquid as the capital market, especially for those workers who have developed some specific skills, the chance of mobility in the labor market is slim. On the other hand, a traditional point of view is that a company in China usually provides an employee a life-long job. Therefore, the interests of employees are specifically addressed by China's Corporate Laws.

408 The other side of the equation, though, is that if workers have developed skills, they cannot be replaced by the corporation except at high cost. Accordingly, managers will have an incentive to voluntarily accommodate some employees' wishes to prevent them from quitting.
this country’s political, historical, ideological, economic and cultural values. With a long period of adhering to a socialist system, and state/public ownership dominance in economic life, a management mode characterized by co-determination with workers in state-owned enterprises is maintained under CCL and FIE Laws. Such co-determination with workers has been deemed a type of socialist democracy. Socialist ideology has for a long time advocated that everybody has a right to work and a socialist country shall have full employment. These have become deeply rooted assumptions in the minds of Chinese workers and managers alike. On the other hand, the social unemployment benefits system in China is not well developed. Therefore, employee interests, especially job security, are given much greater attention by the Chinese government through China’s Corporate Laws.

It should be noted that although employee participation rights exist under CCL and FIEs Laws, the role that employees play in corporate policy making in Chinese corporations is modest. Firstly, the laws fail to establish qualification standards, procedures for the election and removal of workers' representatives, and a framework under which workers can provide input on important corporate matters on an ongoing basis. Labor's right to representation on the supervisory board is provided in ambiguous statutory wording and without any real means of enforcement. Secondly, labor representation in corporate management raises efficiency concerns because most worker representatives lack managerial knowledge. Thirdly, since the supervisory board exercises its rights collectively, in the absence of any provision as to the ratio of labor representation on the supervisory board under the CCL, it is doubtful whether the workers' interests can

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409 Article 16 of 1993 Constitution of the People’s Republic of China:
be meaningfully addressed by the supervisory board in reality.  

Fourthly, the narrow nature of employees' concerns implies a modest role for labor representation.

A comparative examination of employees' collective influences over corporate internal control in Canada and China indicates that employees of CCL companies and FIEs generally have greater influences than their counterparts in Canada. It further demonstrates that corporate control practices under China's Corporate Laws maintain certain socialist doctrines.

4.6 Summary: Corporate Control - From An Internal Perspective

Corporate internal control is a complicated issue. Legally speaking, corporate internal control depends on what a country's corporate law provides in respect of corporate internal structure, the powers vested with corporate participants by the corporate law and the provisions of a corporation's constitutional documents. Practically speaking, corporate internal control is complicated and varies widely from corporation to corporation.

The rationale underlying those features of a country's corporate law dealing with corporate structure is closely connected with that country's historical, political and economic development, legal tradition, ideology and the cultural values of its people. As

"State-owned enterprises practice democratic management through congress of workers and staff and in other ways in accordance with the law."


Generally, workers are concerned about their job security, salary and welfare, and working conditions, whether their skills are transferable or not, and whether more training or education are available. But these issues constitute only a portion of the issues that must be addressed in corporate policy making.
to the provisions under a corporation's constitutional documents, they are a function of the
degree of strictness of corporate law, the expectation of investors at the time of
establishing the corporation, and the professional skills of the drafters of such
documents.412 On the other hand, business reality is in a state of flux. Corporations, in
order to survive within the modern competitive commercial environment, have to improve
their performance. Proper corporate internal control can be one means of achieving
improved performance.

Legal provisions under the CBCA provide for the possibility of a unanimous
shareholders' agreement as a method for tailoring a corporation's management structure
and providing shareholders with direct control over a corporation.413 However, in the
absence of a unanimous shareholders' agreement, the board of directors is given the
statutory power to manage a corporation.414 Moreover, the CBCA permits the board to
delegate part of its managerial power to corporate officers. This corporate internal power
distribution is illustrated in Appendix II - D.

Though this "one-size fits all" corporate internal control structure under the CBCA
fails to recognize different corporate decision-making modes in different types of
corporations in business reality, it acknowledges the shareholders' position in corporate
internal control. Shareholders, as capitalists, have absolute power in managing
corporations provided they act unanimously. It appears that the CBCA's corporate
internal control model is based on capital. However, the corporate internal control model

412 Where the corporate law of a country provides specific prescribed forms for a corporation's
constitutional documents, the professional skills of drafters will not be a factor.
413 CBCA s.102 (1).
414 Ibid.
is not an absolute capitalist model, especially in terms of legal remedies provided by the CBCA for protecting minority shareholders (and other stakeholders also) during the course of corporate decision-making. Therefore, on the whole, the CBCA adopts a modified capitalist model of corporate internal control.

Legal provisions under the CCL provide for the shareholder's meeting as the most powerful organ in a corporation\textsuperscript{415} and recognize the board of directors as the highest authority within a foreign investment company.\textsuperscript{416} China's Corporate Laws further recognize the principle of one share, one vote and majority rule. It seems that, in terms of corporate internal control, legal provisions under China's Corporate Laws adopt many features of capitalism. However, in addition to a number of legal provisions based on capitalist doctrine, China's Corporate Laws also emphasize protection of state interests within corporations even at the expense of disregarding independent corporate personality. Further, minority shareholders (particularly individual shareholders) are discriminated against by China's Corporate Laws. Moreover, the modest positions of boards of directors and managerial officers in Chinese public corporations indicate the vestiges of the enterprise management model from China's socialist planning economy. Nevertheless, labor participation in the corporate decision-making process typically reflects the impact of socialist doctrine upon corporate internal control.

The mix of capitalist and socialist doctrines in the legal provisions regarding corporate internal control under China's Corporate Laws reveals a modified socialist

\textsuperscript{415} Articles 37 and 102 of CCL.

\textsuperscript{416} Article 34 of Implementation Regulations of EJV Law and Article 24 of Implementation Rules of CJV Law.
model of corporate internal control, a model combining socialist enterprise management under the planning economy with features of modern western corporate management.
CHAPTER 5 CORPORATE CONTROL: FROM AN EXTERNAL PERSPECTIVE

The preceding chapter has offered a comparative examination of corporate control in Canada and China from an internal perspective by examining determining/controlling or influencing powers exercised by shareholders, directors, managerial officers, and employees under the CBCA and China's Corporate Law and in Canadian and Chinese business reality.

As the definition of corporate control indicates (see Chapter 1), these determining/controlling or influencing powers over policies or management of a corporation do not exist in a vacuum. They are embedded in, influenced by, and in turn influence, the societal values of a country. Therefore, in this chapter, the issue of corporate control will be addressed from an external perspective through a comparative examination of the role of the state, market, creditors (focusing on banks) and culture in influencing corporate management in Canada and China.

5.1 The State

5.1.1 State Control over Incorporation

By abolishing the notion of incorporation as a grant from the prerogative powers of the Crown, the present CBCA adopts a regime of incorporation as of right.417 This regime eliminates any discretion on the part of the registrar to refuse to issue a certificate

417 Supra note 42 (Dickerson Report) at 18 - 19. See also CBCA s. 8.
of incorporation provided that all necessary filings have been made in accordance with the CBCA. Therefore, governmental control over the creation of corporations is restricted and the incorporation procedure has become effective and convenient to business people.

Unlike the incorporation practice in Canada, in China, the government tightly controls the establishment of corporations through approval procedures specified by China's Corporate Laws and other administrative regulations. To incorporate a publicly held corporation (a listed or unlisted corporation), approvals from both the local government and the central government are required.418 If incorporating a listed public corporation, stricter pre-conditions (relating to such matters as minimum asset requirements and a history of profit-making of the enterprise applying for listing) are required. In addition, an annual quota system419 for issuing shares to the public is employed by the central government for the purpose of strictly controlling the shares to be issued to the public each year. The issuing shares quota system will be discussed in 5.2.1 B below.

With regard to setting up a foreign investment enterprise (a sino-foreign equity joint venture, a sino-foreign cooperative joint venture, or a wholly foreign owned

418 Listed corporations refer to corporations listed on the Shanghai Stock Exchange, Shenzhen Stock Exchange, or foreign stock exchanges. Article 77 and Article 151 of CCL. Article 73 of CCL provides the pre-conditions that a public corporation must satisfy before it can be incorporated.

419 Refer to 5.2.1 B below. In terms of incorporating domestic closely-held corporations (i.e. limited liability corporations under CCL), the incorporating procedure is more like that of the CBCA. Upon meeting conditions provided by the CCL and registration with the state registration authority, the limited liability corporation is established.
enterprise), examination by, and approval from, an authorized state organ is required and this requirement is strictly adhered to.\textsuperscript{420}

The approval procedures for incorporation in China make the process of getting incorporated uncertain and unpredictable. Approval largely depends on administrative officers' discretion. After getting approvals, every corporation has to register itself with a state organ, the state administration of industry and commerce or its local branches, in order to obtain a business license. The business license of a corporation will specify the business scope of such corporation as approved by the approval authorities. Any business activities beyond or in violation of the specified business scope are prohibited and a corporation engaging in such prohibited activities will be penalized by relevant Chinese laws.\textsuperscript{421}

The incorporation style under the CBCA indicates the Canadian government's efforts to facilitate business people's use of the corporate mechanism\textsuperscript{422} and its reliance on the market to exercise quality control in the creation of corporations. China's strict control over the creation of corporations reflects this country's fragile market which lacks

\footnotesize{The pre-conditions for establishing a closely-held corporation are set out in section one of Chapter Two of CCL; for a publicly-held corporation, section one of Chapter Three of CCL; for a listed corporation, Article 152 of CCL; for a sino-foreign equity joint venture, Chapter Two of Implementation Regulations of EJV Law; for a sino-foreign cooperative joint venture, Chapter Two of Implementation Rules of CJV Law; and for a wholly foreign owned corporation, chapter two of Implementation Rules of WFOE Law.


\textsuperscript{421} Article 11 of CCL. Article 11 of Implementation Regulations of EJV Law. Article 8 of Implementation Rules of CJV Law.

\textsuperscript{422} Supra note 42 (Dickerson Report) at 2. Citing H. W. Ballantine, Ballantine on Corporations (Chicago: Callaghan and Company. 1946) at 41-42.}
the strength to screen out misuse and abuse of the corporate mechanism by investors. The Chinese system relies upon prohibitive legal provisions rather than facilitating corporate legislation to protect the interests of the public. The incorporation approach under China’s Corporate Laws is similar to the pre-CBCA system of incorporation by letters-patent that provides public officials discretion in determining the contents of a corporation’s constitution. Whether the regime of incorporation by state approval can achieve the goals of minimizing fraud and abuses, protecting public interests, and ensuring healthy development of corporations as stated by Chinese lawmakers remains to be appraised. But it is without doubt that Chinese state power over the creation of corporations is much more significant than Canadian government power in this area.

5.1.2 The Role of the State in a Corporation's Life

There are two means by which a state can exert controlling or influencing power over a corporation. First, the state may directly participate in corporate decision-making by establishing state-owned shareholding companies or purchasing shares of a corporation. Second, the state may exert influencing power indirectly over corporate policy through domestic laws, regulations, policy and international agreements (especially in connection with tax and trade) to which the state becomes party. This section will focus on the state's

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423 The Law Committee of the National People's Congress, Report of Examination and Discussion on the Chinese Corporation Law (draft) (Quan Guo Ren Da Fa Lu We Yuan Hui Guan Yu "Zhong Hua Ren Min gong He Guo Gong si Fa (Chao An)" Shen Yi Jie Go De Bao Gao) (Dec. 17, 1993) stated that the regime of incorporation by approval is for preventing fraud and abuses of corporations. See also, Supra note 59 at 18 and Supra note 60 at 464: a discussion of abuses of the corporation form during 1986 to 1992 before the promulgation of China’s Corporation Law.
influencing power over corporate policy through domestic corporate law in Canada and China.424

Canada principally adopts a capitalist system.425 Capitalism as a system involves constraints on government, and these constraints are determined in large part by the requirements of business since, ideologically, capitalism is based on the recognition of private property rights. Adhering to many essential capitalist principles426 and a belief in the protection of private property rights, the Canadian government aims in its corporate law to provide a "framework policy" that allows Canadian business to thrive within a proper legal and institutional environment.427 According to Michael Porter:428

...[g]overnment's proper role is as a pusher and challenger. There is a vital role for pressure even adversity in the process of creating national competitive advantage... Sound government policy seeks to provide the tools necessary to compete, through active efforts to bolster factor creation, while ensuring a certain discomfort and strong competitive pressure.

424 It is noted that other laws, for instance, tax laws, may have significant influences over corporate business. In the case of China, the Chinese government has employed tax incentives and designed tax holidays and concessions to attract foreign capital to China's Special Economic Zones and other opening areas. For a description of the Special Economic Zones that attract foreign capital, refer to Supra note 72.

425 It is not clear, however, that Canada is a purely "capitalist" country. More often, it is described as a mixed economy which blends elements of capitalism with elements of socialism. The Canadian healthcare system, for example, seems to embody more socialist than capitalist principles.

426 In Canada, the corporation was designed primarily as a vehicle for raising and using capital in the pursuit of profit. Therefore, it was primarily intended to serve the interests of capitalists (i.e. shareholders). However, it is increasingly recognized that the corporation may also need to take account of other "stakeholders".

427 Supra note 429 at 3. It is noted that though the government of Canada may not interfere significantly with individual business strategy through the CBCA, nevertheless, many other forms of government regulation, like environmental regulations, health and safety regulations, and product safety regulations, have a significant impact on business conduct. In this sense, it may be said that Canada has adopted a modified capitalist system in its political and economic life.

The Canadian government puts the promotion of prosperity and employment at the heart of the government's agenda. But the Canadian government uses other methods (rather than administrative interference) to achieve its goals. The Canadian government seeks to build "a supportive domestic economic policy framework", works for improved access for Canadian products abroad, and aims to develop "an open, fair and predictable set of rules governing trade and investment". Under this state policy, the government of Canada hopes to pave the way for expanded opportunities for Canadian business so as to promote the country's goals of low unemployment and rising prosperity. Thus, direct administrative intervention from the state in Canadian corporate affairs is minimal.

China basically adopts a socialist system. The socialist system involves constraints imposed upon the private sector rather than upon the government. Adhering to a socialist system and a belief in the protection of public property rights, the Chinese government's policy for corporations is to regulate and "standardize". The purpose of standardizing corporations is to integrate the private sector economy into the socialist system. China's Corporate Laws embody the hope of the Chinese government of providing an economic structure for this private/socialist integration and so utilize private and public capital to pursue the socialist aim of full employment and prosperity.

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430 Ibid. at 10.

431 Since the economic reform beginning in 1979, and the adoption of "socialist market economy", it may be hard to describe China as a purely socialist country.

432 Article 1 of CCL. "This law is formulated in accordance with the Constitution of the People's Republic of China in order to meet the needs of establishing a modern enterprise system, to standardize the organization and activities of companies, to protect the legitimate rights and interests of companies, shareholders, and creditors, to maintain the social economic order and to promote the development of the socialist market economy." (emphasis added)
For instance, employees' interests within corporations have been paid particular attention by China's Corporate Laws. In addition to labor-management co-determination provisions under China's Corporate Laws, as mentioned in section 4.5 above, China's Corporate Laws further provide compulsory provisions for corporations to fund unions every month in order to ensure that unions in Chinese corporations have funds to organize certain activities relating to collective welfare.\(^{433}\) The state policies are more often expressed through corporate laws and regulations in a compulsory, prohibitive and negative way and often expressed in a way that limits the corporation's business freedom so that the state can align the corporate business with state policy. Thus, to comply with state policy, corporations must frequently promote employment at the expense of corporate efficiency.

As an economic structure, the corporation plays a key role in determining whether the Chinese government can achieve its socialist aims. Therefore, the state is eager to exert its will on corporations for the purpose of achieving state policy goals. It is without doubt that in China the state exerts more state policies to influence corporate decision-making than does the state in Canada.\(^{434}\) This leads to corporate control practices under

\(^{433}\) "Collective welfare", i.e. Ji Ti Fu Li. No definition is provided by Chinese law. Practically, it refers to facilities provided by a company for its employees for enhancing employees' interest in work or improving employees' health, e.g. reading room, gym and so on used by employees. Article 72 of Implementation Rules of WFOE Law and Article 99 of Implementing Regulations of EJV Law. These articles provide that a foreign investment company shall actively support the work of its unions and, in accordance with the laws of the People's Republic of China on Labor Unions, provide them with the necessary premises and facilities for office work and meetings and for use in organizing collective welfare, cultural and athletic activities for staff and workers. A foreign investment company must each month allocate labor union funds at the rate of 2 per cent of the total pay of their staff and workers. Such funds are to be used by their labor unions in accordance with the measures for the use of labor union funds formulated by the All China Federation of Trade Unions.

\(^{434}\) It is noted that in China, when corporations seek to amend certain provisions in their constitutional documents, in addition to obtaining the consent of their shareholders, they must also obtain the approval of the relevant state organ. This requirement for approval of amendments corresponds to the requirement of incorporation by state approval in China.
China’s Corporate Laws that embody a combination of modern corporate control features of western countries’ corporate laws (in order to attract private capital into China’s equity markets) and elements of the traditional socialist model of enterprise management (in order to maintain continuity with socialist doctrine).  

5.2 The Market

Externally, in addition to the state, the market is also one of the vital factors that influences corporate control. However, it was not until the 1970s and 1980s that law and economics scholars realized that markets also played important roles in disciplining corporate conducts and influencing corporate decision making. These markets include the capital markets (debt and equity markets), the corporate control market (i.e. takeover

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435 Another argument made to support state interference with corporate business in China is that to some extent, a relatively strong state influence in a corporation’s life makes sense in today’s China. The less efficient the underlying market mechanisms to regulate corporations, the greater the need for government regulation. Thus, there is a significant role for the state to play in Chinese corporate life during the period of building China’s market economy. Such a strong role for the state also makes sense considering the fact that China has a large number of unsophisticated individuals buying and selling shares. These naive investors (who generally lack professional investment advisors) are unable to assess the risks involved with investing in China’s immature market. Many individual Chinese investors are unaware that they may jeopardize their financial future by placing their life savings in schemes offering highly volatile returns and fail to give sufficient weight to the possibility of their investment becoming worthless. They are more easily influenced by media and, thus, are apt to take a stake in corporations that will never result in adequate returns on their investment. These facts contribute to an environment in which the state has considerable room to intervene in the marketplace. The state, by regulating or sometimes over-regulating the marketplace, is capable of discouraging individuals from developing schemes designed to mislead unsophisticated investors, preventing artificial market manipulation and helping to channel private investor funds to less risky investments.

436 See e.g. R. Gilson, "The Case Against Shark Repellant Amendments: Structural Limitations on the Enabling Concept" (1982) 34 Stan. L. Rev. 775


market), the product/service market, and the managerial service market. In addition to these markets, this thesis will also address the influence of media coverage upon corporate decision-making.

5.2.1 The Capital Market

The capital market consists of the market for equity and long-term debt.\footnote{437} The capital market can discipline managerial behavior. Management has to consider the terms on which capital will be supplied to the corporation. No corporate managers want to take steps that will increase the cost of financing the corporation.\footnote{438}

This section focuses on the equity markets in Canada and China and their respective impacts upon public corporations in the two countries. Debt markets, and their respective influences upon Canadian and Chinese corporations, are addressed in section 5.3 below.

A The Equity Market in Canada

The equity market in Canada is composed mainly of Canada's five stock exchanges and an established "over-the-counter" market. Among the five stock exchanges (that is, the Toronto Stock Exchange, the Montreal Exchange, the Vancouver Stock Exchange, the Alberta Stock Exchange and the Winnipeg Stock Exchange), the Toronto Stock

\footnote{437} It is noted that the market for short-term debt is usually referred to as the money market.

Exchange (TSE), is the most influential stock exchange in Canada. The TSE is the 9th largest securities exchange in the world based on market capitalization, accounting for over 80 per cent of the value of shares traded on Canadian stock exchanges.\textsuperscript{439} Notwithstanding that the TSE's principal function is the listing of common shares, it also permits investors to make equity investments through listed proprietary derivative products, trust units, closed-end funds and other equity-linked products.\textsuperscript{440} Canadian investors purchase equities directly and also indirectly through mutual funds.\textsuperscript{441} Unlisted shares of public corporations may also trade actively in the so-called "over-the-counter" market in Canada.

The Canadian equity market principally involves trading in shares of two types of corporations. The first type is the public corporation, the shares of which typically trade in markets characterized by a large float of publicly traded securities, high liquidity and significant institutional shareholdings. The other type is the smaller public corporation which typically has a much smaller float of publicly traded securities, relatively low liquidity, and low institutional ownership.\textsuperscript{442} Canadian equity markets are dominated by the latter.\textsuperscript{443} Most trading in the shares of illiquid public corporations with few

\textsuperscript{439} J. R. Lloyd (from Blake, Cassels & Graydon), "Canada's Capital Markets" online: World Legal Forum, <http://www.worldlegalforum.co.uk/canada/articles/1997100183.html> (date accessed: June 28, 1999).

\textsuperscript{440} Ibid.

\textsuperscript{441} Ibid. As of December 31, 1996, there were over 950 funds in Canada investing in a broad range of domestic and foreign equities as well as debt and other financial instruments. The Investment Funds Institute of Canada recently reported that total assets under management by Institute members amounted to Cdn$273 billion, and that these assets were held through over 30 million accounts.

\textsuperscript{442} Supra note 124 at 877.

\textsuperscript{443} Ibid.
institutional shareholders occurs between retail investors.\textsuperscript{444} The predominant role played by such corporations in Canadian equity markets is consistent with observed patterns of corporate ownership concentration. As pointed out in section 4.1.3, one of the characteristics of Canadian corporations is high ownership concentration. As shown in Appendix II - B, a corporation with highly concentrated ownership is normally governed by a single shareholder or a small group of shareholders or their nominees. The fact that many Canadian corporations have controlling shareholders implies that the market for those corporations' shares will be relatively illiquid since the true public float will be relatively small.

However, one cannot overlook the large sources of capital represented by chartered banks, life insurance companies, public and private pension funds and mutual funds in the Canadian equity market.\textsuperscript{445} The very existence of institutional shareholders and their large interests in public corporations has attracted the attention of Canadian researchers.\textsuperscript{446} Since institutional shareholders have access to sophisticated in-house market professionals, they have the expertise and ability as well as the incentive to monitor the corporations in which they have invested. Their presence, accordingly, offers a very real hope for the effective monitoring of large public corporations. (Please refer to 4.1.7 A (3) above.)

The equity markets may generally provide some discipline over corporate decision making through the share pricing mechanism. In a well functioning equity market, the

\textsuperscript{444} Supra note 265 (J.G. MacIntosh).


\textsuperscript{446} Supra note 133.
prices of shares of corporations should reflect the relative operational efficiency of such corporations.\footnote{A necessary pre-condition for such direct reflection of operational efficiency in share pricing is that all material information relating to the corporation is rapidly and properly disclosed without distortion.} A mature equity market is the ideal instrument through which to translate the effectiveness of corporate management into the prices of a corporation's shares. Share prices, then, function as one of the indicia of managerial performance, and can be used as a benchmark by which to motivate corporate controllers to maximize corporate profits.

Stock exchanges also play a regulatory role by requiring publicly-held corporations to adopt sound corporate governance practices. The TSE, in order to promote sound corporate governance in Canadian public corporations, published the Dey Report, a landmark study on corporate governance, in 1994.\footnote{Supra note 20.} The TSE requires listed corporations to disclose and explain any difference between their corporate governance practices and the guidelines in the Dey Report, though it does not expressly require listed corporations to adhere to these guidelines. Five years after the publication of the Dey Report, in order to assess the extent to which the corporate governance practices of listed public corporations reflect these guidelines, the TSE and the Institute of Corporate Directors issued a follow-up study on 635 TSE-listed corporations.\footnote{Supra note 21.} The TSE has thus been helping to define proper corporate internal control standards for corporations, investors and the Canadian equity markets.
It appears that institutional shareholders, the share pricing mechanism and stock exchanges all perform a disciplinary function in influencing corporate control practices in Canada.

B The Equity Market in China

It was not until the 1990s that an equity market in China was established. In 1990, China established the first national stock exchange - the Shanghai Stock Exchange. At the end of the year 1990, there were 13 listed public corporations in China. Later, in 1991, the Shenzhen Stock Exchange was set up. Shortly thereafter, the two markets were unified and further standardized through a sophisticated over-the-counter computer network – the National Securities Trading Automated Quotation System (NSTAQS). Through NSTAQS, more than five thousand brokers and dealers scattered across China are able to buy and sell both equity and debt securities. Though at the end of 1997 there were 10,000 publicly-held corporations in China, only 745 of those were publicly listed and traded on the Shanghai and Shenzhen Stock Exchanges.450

The introduction of a securities market into China was not without controversy. As analyzed in 3.2 above, unlike the reforms undertaken in Russia and most of Eastern Europe, which saw social ideology relinquished during the process of privatization, economic reform in China has had as its distinctive feature the preservation of socialism. Socialism is characterized by the dominance of the state/public economy. However, the securities markets in the west are dominated by the private sector. The concern of the

Chinese government, in permitting the introduction of equity markets in China is obvious: that private economy may gradually erode the state/public economy in China.

Prompted by the shortage of capital and the lack of incentives to improve enterprise management, the government finally introduced the corporate form of business organization in the 1980s and an equity market in China in the early of 1990s. From their inception, these experiments with the corporate form and the establishment of a securities market were based on the official presumption that state enterprise management could be upgraded simply by adopting modern corporate forms and diversifying shareholding while preserving the state's controlling stake. In order to employ the devices of corporations and of securities markets found in the west while at the same time preserving socialism, the Chinese people created equity markets with "Chinese characteristics". In other words, the public economy plays a dominant role in the Chinese equity market.

As analyzed in 4.1 above, Chinese corporations have a high concentration of state/public shares. The unique share classification structure in China reflects the state's concern over the position of the state/public economy. The extraordinary shareholders' rights provided by CCL and the neglect, conscious or unconscious (see 4.1 above), of minority shareholders' interests, strengthen the power of the majority shareholders (i.e., the state or other public sector actors).

With regard to the equity market in China, the dominant position of the public economy is maintained through the shares issuing quota system and the restrictions placed on trading.

(1) Issuing Shares in the Primary Market: The Quota System
The Chinese government maintains high state/public ownership of shares through its shares issuing quota system. In brief, relevant national authorities set a figure, or quota, for the aggregate offering price of issuance of all shares in the whole country during a year. The quota then is allocated to provincial governments, ministerial authorities, and municipalities directly administrated by the central government, usually on the basis of local economic development. After receiving its issuance quota, the local authority will conduct an examination of all applicants for incorporation of a public offering corporation or for a public offering of securities according to China's Corporate Laws and other laws and regulations. If the local authority determines that an applicant is qualified to issue shares, it then agrees to assign the applicant an issuance quota and approves the application for offering. This local approval is then submitted to the central government for a final approval. Upon receipt of approvals from local and central governments, the applicant may, if it wishes, apply to have its shares listed on the Shanghai or Shenzhen Stock Exchange. After examination and approval by the stock exchange, the corporation can then make a public offering.

The weaknesses of the shares issuing quota system are obvious: employing approval procedures for incorporations and public offerings tends to be highly political and unpredictable. The quota system provides a mechanism for administrative control of the securities market and accentuates the market's political content. All these offerings

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451 Four cities, Beijing (the capital of China), Shanghai, Tianjing and Chongqing, are the municipalities directly administrated by the central government.

are subject to plans formulated and administered by the governments.\textsuperscript{453} A number of state authorities jointly decide upon the plans for annual shares issuance and the total number of corporations to be listed on the Shanghai and Shenzhen Stock Exchanges. Each province is given a quota of new listings. The selection at the provincial level is in principle based on local industrial bureaus' recommendations and the overall balance between industrial sectors. The final decision then lies with the central government. In this regard, which corporations can be incorporated and listed is decided by the state plan. Actually, on average, 70 per cent of every corporation's shares are owned by the state and legal persons.\textsuperscript{454} Therefore, owing to the state policy of commitment to socialism, the maintenance of the dominant position of state/public ownership in the equity market, and the careful administration of the share issuing quota system, the primary market for Chinese equity securities is strictly controlled by the government and maintains a socialist character.

(2) Share Trading on the Equity Market

China's capital market to a large extent is illiquid. The reason for this illiquidity is that state shares and legal person shares cannot be traded (unless approval from the relevant state authority is obtained) on the securities market under current Chinese

\textsuperscript{453} By restricting access to the formal national share markets, the quota system actually pushes non-quota activities into other venues, for example, securities trading centers set up in major cities and sponsored by local governments and the local People's Bank of China.

\textsuperscript{454} Fang, Liufang, "Comments: China" (1997) 28 L. & Pol'y Int'l Bus. 897 at 897. For the definition of "legal person", see supra note 108.
regulations.\textsuperscript{455} It is estimated that around 70 per cent of shares in China's equity market are owned by the state and legal persons.\textsuperscript{456} This means the true public float for Chinese corporations is relatively small. Moreover, regulations provide that an individual shareholder cannot purchase more than 0.1 per cent of the outstanding shares of a listed corporation.\textsuperscript{457} Further, capital markets in China are characterized by an absence of institutional shareholders. Insurance companies, for example, are prohibited from investing in the securities market,\textsuperscript{458} as are pension funds.\textsuperscript{459}

The secondary market is overwhelmed by household individual investors. Most of them lack sophistication, knowledge, time and investing savvy, and are less likely to monitor the corporations in which they invest. Instead of engaging in long-term investment, many of these individual investors are engaged in short-term speculation.

\textsuperscript{455} Article 36 of \textit{Provisional Regulations on the Administration of Issuing and Trading of Stocks} (issued by the State Council of the People's Republic of China on April 22, 1993).

\textsuperscript{456} Another estimation made by Vandegrift is that, of the outstanding shares for any corporation, only 20 percent can actually be traded on the Shanghai Stock Exchange or Shenzhen Stock Exchange. A shares and B shares respectively account for 18 percent and 2 percent within that 20 percent of traded shares. Of the remaining non-trading securities, national, provincial and local governments hold 30 percent, state-owned enterprises and domestic institutions own 45 percent, and issuers and their employees hold 5 percent. See \textit{supra} note 118.

It has also been estimated that more than 98 percent of Chinese public corporations' shares are not tradable in the market given the large number of non-tradable state shares and employee shares. See \textit{supra} note 122.

\textsuperscript{457} \textit{Supra} note 207.

\textsuperscript{458} Article 104 of \textit{Insurance Law of the People's Republic of China} (Ratified at the 14th Session of the Standing Committee of the Eighth National People's Congress on June 30, 1995, and promulgated by Presidential Decree No. 51 for implementation commencing on October 1, 1995).

\textsuperscript{459} Article 4 of 1990 \textit{Notice of Labor Ministry Concerning Strengthening the Payment and Management of Pension} (Lao Dong Bu Guan Yu Jia Qiang Lao Bao Xian Ji Jin De Zhen Guan He Guan Li Gong Zuo De Tong Zhi).
The highly regulated equity markets for both primary offerings and secondary trading ensures the continued controlling position of public ownership in China's equity market. The predominant position of the state/public in shareholding corporations and in the equity market allows the managers of former state enterprises to continue to operate without effective supervision. In the meantime, the illiquid equity market is volatile and vulnerable to manipulation for reasons related to its small size and the extent of administrative controls. The government sometimes directly intervenes to prevent a collapse of the securities market given that it is a source of capital that helps drive China's economic growth.460

The highly regulated equity markets not only increase agency costs but also facilitate official corruption. The share issuing quota system makes public offerings depend on the discretion of officials. The unjustified prohibition against individual shareholders holding over 0.1 per cent of the outstanding shares of a listed public corporation is a sign of discrimination against private shareholders and private economy.

460 The following example illustrates state intervention in China's stock market: "In July 1994, the Shanghai market sank to a record low close on July 29 to finish at 328.84 points. The Shenzhen A index crashed through its 100 starting level for the second time in its four-year history, closing at a record low 95.34 points. On Friday, July 29, after an emergency meeting in Beijing among CSRC (China Securities Regulatory Committee) officials, State Council aides and officials from the two stock exchanges, the government decided on a rescue plan. The CSRC's rescue plan measures, plastered on the front pages of the official press the next day, included a freeze on all new share issues held over from 1993 for the remainder of the year. They also hinted at allowing joint Chinese-foreign fund management firms limited access to the market on a trial basis. 'To address the problem of a lack of institutional investors, we have opted for the creation of Chinese and mixed investment funds capable of attracting foreign capital,' said Liu Hongru, Chairman of CSRC. A third measure was to ease credit to the government's most important securities and investment firms. Beefed up brokerages, another aspect of an empowered investor base, would be able to intervene in the market." See J. Ma, "China's Economic Reforms in the 1990s" online: <http://members.aol.com/junmanew/chap3.htm> (date accessed: June 26, 1999).

However, to some extent, intervention in this new-born high risk capital market is necessary in terms of protecting investors. For instance, in order to prevent fraud and corruption in the capital market, in November 1996, China Securities Regulatory Commission (CSRC) issued a set of rules requiring brokerage firms to obtain licenses to participate in stock brokering activities. In the meantime, the CSRC punished several brokerages for illegal securities transactions. Now the issue is to what extent the government may exercise its power to intervene in the capital market.
Through the share issuing quota system and restrictive regulations on the share trading market, the Chinese government controls China's equity market. This state intervention together with the relatively small size and illiquidity of the equity market, means that the share price mechanism which plays a disciplinary function for Canadian corporations may not exercise the same function in China. China's infant stock exchanges and lack of institutional shareholders further suggest that the influence of equity markets upon corporate control in China is not significant.

5.2.2 The Corporate Control (takeover) Market

Theoretically, a well functioning corporate control market serves to encourage strong managerial performance since weak management will cause share prices to fall and lead to a takeover bid followed by a replacement of management. The corporate control market, therefore, provides a mechanism for displacing inefficient corporate controllers and maintaining a high share price.\(^{461}\)

The corporate control market in Canada is not active compared with that of the US.\(^{462}\) The main reason for this difference may be that Canada has a high ownership concentration in corporations.\(^{463}\) The predominance of controlling shareholders makes hostile take-over bids far less likely.\(^{464}\) Mergers and acquisitions are, accordingly, more likely to be completed by negotiated transactions. There are a number of other means by

\(^{461}\) Supra note 436 (H.G. Manne) 110 at 112-113.

\(^{462}\) Supra note 124 at 887.

\(^{463}\) Refer to 4.1.3 of this thesis.

\(^{464}\) Supra note 124.
which takeovers may be thwarted as an effective mechanism of corporate control. First, existing corporate management is well equipped to take strategic actions to hinder hostile take-over bids such as putting in place poison pills, amending constitutional documents of the corporation, initiating legal challenges to bids, and so on to. Second, it is costly for prospective bidders to conduct the research necessary to determine which corporations are under-performing relative to their potential. But once the research is done, any takeover bid made on the basis of such research immediately signals to other potential bidders that they should also take notice of the target corporation. Thus, the inability to keep take-over bids secret may create an obstruction to the market for corporate control. Third, it is observed that small shareholders of target corporations have an incentive not to tender their shares unless the value of the bid sufficiently reflects the expected increase in profitability under new management.

China also has an inactive takeover market. One reason for this is the high ownership concentration of Chinese corporations. In addition, restrictive legal and regulatory provisions which prohibit individual shareholders from holding over 0.1 per cent of outstanding shares of listed public corporations make it impossible for any private investor to take control of a public corporation. The regulatory requirement that state shares and legal person shares must be non-tradable also contributes to an inactive takeover market. Finally, the small size of the capital market in China and direct

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465 Supra note 438 at 48.

466 Ibid.
administrative intervention in the market operate to prevent an active merger and acquisition market from developing in China.467

5.2.3 The Product/Service Market

The product/service market can affect corporate control due to the fact that a corporation's share price is closely connected with the price, quality and marketability of its products and services.468 Moreover, if a corporation is not run efficiently and able to produce marketable products or services at competitive prices, the corporation will face the danger of insolvency or bankruptcy.

Competition in the product or service market varies from case to case. Big corporations with strong brand names built over a long corporate history may dominate the specific product or service market temporarily even though the corporation, at any particular point in time, is not effectively run. Under Chinese state policies which encourage corporations with controlling state shares to expand their market shares and discourage them from becoming bankrupt, inefficiently operated corporations may

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467 The state government from time to time issues notices to bar transfers of a controlling interest in some state-owned corporations. See supra note 452 at 764. It appears, at first blush, that takeover transactions are prohibited in China's equity markets. However, mergers and acquisitions do exist in China. Usually such transactions occur between state-owned enterprises upon approval of the relevant state authority.

468 In stating this criterion, I have excluded certain conditions, i.e. performance of the whole industry and the assumption that the consuming behavior of most people or end-users is static. That is, one can only draw a link between product quality and share price if consumer preferences are assumed to be constant. To use a simple example, a company may produce the world's most high quality product, for instance, widgets. But if consumers suddenly stop buying widgets, from anyone, that corporation's share price will fall even though the quality of its products is excellent. "Performance of the whole industry" is getting at a similar point. If a company is in a declining industry, share prices may fall even if that particular company's products are excellent.
continue to occupy the market. Such policies, then, act as impediments to the discipline function that might otherwise exist in product/service markets.

In Canada, product/service markets have always been competitive, and in recent years have become increasingly so. Adoption of the NAFTA has pushed Canadian corporations into a broader competitive market in North America and forced them to improve corporate performance by exposing them to greater international competition. China, on the other hand, needs no trade agreement to provide Chinese companies access to a large market. Its population of over 1.2 billion people makes China the biggest consumer market in the world. For now, however, competitive forces in China are primarily domestic. China is still waiting outside the door of the World Trade Organization. Therefore, temporarily, the threat of competition from the global product/service market is generally much less than in Canada.\textsuperscript{469}

5.2.4 The Managerial Service Market

To professional managers, the market value of their services within and outside the corporation is decided by their ability to maximize the profits of the corporation. Outside the corporation, the external managerial service market assesses the value of managers by observing the performance of the corporation with which they are currently associated. Professional managers may be motivated by the prospect of increasing the market value of their services to other corporations that may seek to employ them, and thus have a stake in maintaining their reputation as profit generators. Inside the corporation, junior

\textsuperscript{469} It is noted that there is considerable domestic competitive pressure in China, especially among foreign investment companies and between state-owned companies and foreign investment companies.
managers monitor the performance of senior managers by utilizing their "firm specific information".\footnote{Supra note 128 at 19.} Because top management positions in corporations are usually filled internally, ambitious individuals seek to climb higher in the corporate hierarchy. However, the competition of the managerial labor market might not have such effects in companies where managers hold substantial voting shares.\footnote{There are two issues here. First, in corporations where there is a large controlling shareholder, who is also a senior manager, junior managers will have less incentive to monitor senior managers with the hope that they can outperform those managers and therefore be promoted, because no matter how well they perform, if the senior managers are also the controlling shareholders, no such promotion is possible. The second issue is that if senior managers are (wealthy) controlling shareholders, they may have less incentive to perform since (1) they have plenty of money and are not as attracted by the possibility of a better job at another firm; and (2) if they hold substantial shares, they are not at risk of being "fired" by the shareholders.} Thus, in public corporations with high ownership concentration, if controlling shareholders act as managers, the managerial service market might not have an effective disciplinary function for them.

The Canadian managerial service market is not very competitive (especially in the new knowledge-based economy period) compared with that of other developed countries.\footnote{The 1994 World Competitiveness Report ranked Canada 19th out of 41 countries (23 developed and 18 less developed) on the management factor. Industry Canada, Management Skill Development in Canada (Canada: Occasional Paper Number 13, December 1995) at 5.} But, as a developed country, the Canadian managerial service market is likely superior to that of China, a developing country.

The managerial service market in China may not act as an incentive for improving corporate internal control in Chinese corporations because first, there is no real fear of job loss for under-performing Chinese managers because of a shortage of managerial talent in China; second, because most Chinese managers are only beginning to learn how to manage profit-making businesses and accordingly, are far from having the skills needed to
distinguish themselves from other managers; and third, because an ambitious manager would not necessarily be promoted in China since the state has control in corporations and the state is currently more concerned to see managers prevent corruption than to maximize profits.

5.2.5 Media Coverage

Media coverage also plays a role in disciplining corporate controllers' business behaviors and affects corporate decision making given that corporations compete for favorable media coverage, and reputation effects or embarrassment may serve as an incentive to corporate decision-makers for avoiding poor corporate performance and disciplining their misbehaviors. The threat of adverse media coverage might be a more significant deterrent to the Chinese since the traditional culture of "saving face" has been deeply rooted in the Chinese people. Chinese managers and corporate controllers are no exception of this.

The concept of "saving face" in Chinese culture is not just avoiding embarrassment in public situations. In China, face is a complex reality that is associated with trust, with family members, with respect and social status. Once it is destroyed, the person might

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474 Refer to 5.5 below in the text.

475 An article discussing doing business in China and Chinese culture, including "saving face" can be retrieved from W. Gertmenian, "Cultural Insights on Doing Business in China, Concepts of 'Face' and 'Trust' are Just the Beginning", The Graziadio Business Report, Online: University of Maryland, School of Law, China Law Site: <http://www.qis.net/chinalaw/search1.htm> (date accessed: June 26, 1999).
not have value in Chinese society. For shareholders, creditors and employees, corporate failure is an outcome which entails devastating financial hardship, and in the case of directors and managers, profound personal embarrassment and detriment to self-esteem. The deterrent power originated from traditional culture cannot be underestimated. In order to maintain respect, managers and other corporate controllers will have strong incentives to discipline themselves.

5.3 The Creditor - Bank (the Debt Market)

A bank usually has two reasons for intervening in the business of a corporation. One is that the bank may have equity ownership in the corporation. The other is that the bank may be a creditor of the corporation. In other words, banks serve as the corporation's debt market. In this section, I will address the latter situation in the context of considering the issue of corporate control from an external perspective.

5.3.1 In Canada

The interests of a creditor and a corporation conflict if the corporation pays unlawful dividends to shareholders, or improperly reduces capital so as to render the corporation insolvent, or purchases its own stock out of capital.477

476 Of course banks are only one source of debt capital. Corporations can also borrow money from other institutions or in the capital markets by way of public issues of debt instruments such as debentures

477 Supra note 10 at 175.
For a profit-making corporation, the influence of bank creditors in the form of intervention in corporate affairs is slim. Firstly, for banks, the return on their loans to corporations is fixed according to certain contractual arrangements. Secondly, banks' debt claims would rank above the interests of shareholders in the event of insolvency or bankruptcy of the corporation. Thirdly, bankers lack the expertise and time to be involved in corporate business. Participating in corporate affairs, unless the corporation is in financial distress, in a banker's eyes, is too costly.  

Finally, for banks, the risk of default will be largely reduced through diversification because usually banks lend money to a large number of corporations.  

To a corporation with serious financial problems, banks might be willing to take interventionist action to prevent corporate controllers from gambling with creditors' funds and pursuing a high-risk and high-return strategy which could be good for shareholders (who, after all, have nothing to lose once a corporation is on the brink of insolvency and have the possibility of recovering some value) but potentially contrary to the creditors' interests.  

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479 *Ibid.* at 75. The problem with the diversification argument in the case of debt as opposed to equity is that, at best, it means that lenders can be insulated from complete financial collapse by lending to large numbers of borrowers who are not likely to all default on their obligations at once. However, defaults are still costly, because unlike the case of diversified equity holders who might lose money on one investment but make up for it on another, the maximum return for debt-holders is fixed. So debt-holders, even if diversified, still need to be more concerned about individual defaults and insolvencies than diversified equity holders.

However, there is no good reason for wanting to see banks take a significant interventionist role in the affairs of a corporation with no serious financial problems. First, banks' rights to intervene in the management of a solvent company will be limited by the terms of their loan arrangements. Banks might perform a useful monitoring function during the life of a loan arrangement; however, not every strategy that banks favor would necessarily be a good management strategy from the perspective of shareholders and of corporate growth in general. Second, the real weapon banks have in their fight against irresponsible corporate borrowers is the threat of demanding repayment, rendering borrowers insolvent or placing them into bankruptcy. But the risk of such bank discipline on managerial performance is that it could compel managers to become more conservative, that is, less interested in pursuing profit-making strategies and more interested in preserving the company's assets. Such conservative attitudes of management might not ultimately be desirable for either shareholders or bankers since, in the long run, both shareholders and bankers benefit from the prevalence of a well-run corporations which are generating profits sufficient to service bank loans and distribute dividends to shareholders.

The influence exercised by banks over corporate management varies from case to case, with the extent of such influence generally being proportionate to the amount of a corporation's outstanding loans and the financial situation of the borrower. In general, however, there is no good reason for wanting to see banks take a significant role in interfering with corporate management either in well-run corporations or in corporations with serious financial problems. Research conducted by Industry Canada in 1996 found
no convincing evidence to support a broader role for banks in Canadian corporate governance.\(^{481}\)

5.3.2 In China

China's banking market is an oligopoly with the state banks occupying the most prominent position.\(^{482}\) During China's planning economy period, since all the banks were owned by the state, and all the enterprises were either state owned or collectively owned, there were no commercial loans between the state banks and state enterprises. The banks simply allocated funds to enterprises according to certain state plans. With the recent economic reform and the diversification of business ownership, financial reform, including bank reform, has begun in China starting from 1995.

Briefly, the function and responsibility of the Chinese central bank - the People's Bank of China - was established in 1995.\(^{483}\) The People's Bank of China, under the leadership of the State Council, is equipped with indirect tools for the conduct of monetary policy and for the exercise of its supervisory functions over other banks and non-banking financial institutions in China.\(^{484}\) Other state banks in China were required to

\(^{481}\) *Supra* note 348 at 47.

\(^{482}\) By 1993, China's banking system mainly consisted of the following specialized banks and non-bank institutions: (1) the Agriculture Bank; (2) the Bank of China; (3) the Construction Bank; (4) the Industrial and Commercial Bank; (5) Rural Credit Cooperatives; (6) Urban Credit Cooperatives; (7) the Bank of Communications; (8) the China International Trust and Investment Corporation; (9) Guangda Finance Corporation; and (10) the People's Insurance Company.


be commercialized and capitalized beginning from 1995. The four state specialized banks (that is, Bank of China, China Construction Bank, China Industrial and Commercial Bank, and China Agricultural Bank) have been required by law to transform themselves into commercial banks. Three policy banks were established in 1994 for separating policy lending from commercial lending. In June 1995, the first commercial bank aimed at providing financial services for private corporations, Minsheng Bank, was set up in China.

485 Under China's planning economy phase, since the needs of people and enterprises were met by direct allocation from the state, there was no device required for the management of savings and investment. People's Bank of China was in charge of the state financial system. Its department, Bank of China, managed China's foreign exchange transactions. The Ministry of Finance used the only other bank, the Bank of Construction, for the management of long term credits to finance the state-planned projects. No stock market and other financial intermediaries were available at that time. There were some reforms of institutions focusing on credit control during the 1980s and early 1990s before the promulgation of the 1995 People's Bank of China Law.


486 1995 Law of the People's Republic of China on Commercial Banks (adopted at the 13th Meeting of the Standing Committee of the 8th National People's Congress, promulgated by Order No.47 of the President of the People's Republic of China on May 10, 1995, and effective as of July 1, 1995).

The four specialized banks were handling around 90% of total bank assets and two thirds of all financial assets. A phenomenon that I cannot neglect in addressing China's banks is the high personal savings rate in China. The traditional Chinese culture of high savings in households and of avoiding personal debt leads to a high accumulation of private deposits in state banks. The savings rate in China is about 40 per cent of income. Total savings deposits in China exceed 8 trillion Renminbi (about US$1 trillion). See A. NeoH, "China Strengthens Its Markets" (January 14 1994) Online: Far Eastern Economic Review <http://www.feer.com/Limited/index_business.html> (date accessed: June 17, 1999).

The high savings rate gives the Chinese private sector the ability to produce high levels of investment capital. It is the wealth represented by these private savings that the Chinese government wants to tap in order to fund Chinese industries. High private saving is also one of the reasons that led to the inception of laws relating to the incorporation of enterprises and the establishment of a securities market.


Policy banks were established during China's financial reform to take over the allocation of state credits which were carried over from the old-style planning mechanism. The three policy banks are the State Development Bank, which was created by merging the six investment companies under the State Planning Commission; the Agricultural Development Bank of China; and the Export-Import Bank. They were to have assumed all the policy based lending activities formerly handled exclusively by the specialized banks.
By 1998, more than one hundred foreign banks had established branches or representative offices in China. However, few of them have been permitted to access the Renminbi (Chinese currency) inter-bank market. All of them are subject to tight restrictions on the scope of their business. The first sino-foreign investment bank in China was approved for establishment in 1995.488

With the transformation of state banks into commercial banks, the old capital allocation system has ended and loan agreements must now be signed between corporate borrowers and their banks. But actually, the disciplinary influences exerted by banks upon corporations are slim given that in China commercial banks are largely owned by the state and most corporations also have a high concentration of state ownership. Reform in the banking area, to some extent, just means that state commercial banks will not help rescue insolvent corporations because they are now making loans on the basis of commercial considerations only.

5.4 The Court

5.4.1 In Canada

As mentioned in Chapter 2 above, the evolution and refinement of Canadian corporate law have been influenced by British company law and American corporate law. However, it is uncertain whether Canadian courts have had a strong or modest influencing power over corporate governance.

488 This bank was a joint venture between a Chinese financial institution and Morgan Stanley.
The "internal management rule" developed by the English courts and the "business judgement rule" developed by the American courts both have influenced Canadian courts dealing with cases relating to corporate management.

In the case *Foss v. Harbottle*, the court adopted an attitude of non-interference with the internal management of a corporation. If a particular proposal had majority approval and the majority was acting honestly and in good faith, "the Court will not substitute its opinion for the decision of the shareholders unless very strong grounds are shown for doing so". Further, in the case, *Burland v. Earle*, the Privy Council held that, "[i]t is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so."

According to the US "business judgement rule", US courts will not normally interfere with the exercise of business judgement by corporate management so long as the managerial decision have been taken on a reasonably informed basis and is not tainted with fraud, illegality, or conflict of interest. That is, the US courts, in recognition of the business risks inherent in the activities of a profit-oriented business corporation, have expressed their reluctance to be involved in corporate business decisions, as long as such decisions do not involve fraud or self dealing and are made on an informed basis and in pursuit of what the directors honestly believe to be in the best interests of the corporation.

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489 (1843), 2 Hare 461; 67 E.R. 189 (Ch.)

490 Ibid.

491 *Burland v. Earle* (1901) A.C. 83 at 93 (P.C.)

492 Supra note 239 at 19.
Influenced by English and US judgements, the traditional approach of Canadian courts was that business decisions were internal management matters for the directors and the majority shareholders, and the court would not interfere with them as long as the decisions were made honestly and in good faith.

While the "internal management rule" or "business judgement rule" is still very much alive in Canada, the CBCA affords courts great discretion when hearing cases relating to the oppression remedy. The Dickerson Report envisioned that the judiciary should have a relatively broad role in corporate matters.\(^{493}\)

\[\text{\ldots the best means of enforcing a corporation law is to confer reasonable power upon the alleged aggrieved party to initiate legal action to resolve his problem, making the Draft Act largely self-enforcing, obviating the need for sweeping administrative discretion and harsh penal sanction, and, at the same time, forcing resolution of the issue before the courts, which have the procedures, the machinery and the experience that enable them better than any other institution to deal with such problems… (emphasis added)}\]

The Dickerson Report further clearly identified the status of courts in protecting minority interests in the corporation:\(^{494}\)

\[\text{\ldots the remedies provided in the Draft Act recognize that corporation law - and particularly the duties of officers, directors and dominating shareholders of corporations - is in a very fluid state, reflecting the uncertain role or identity of the business corporation in contemporary society. For this reason we have frequently established only very broad quality standards of conduct, ... permitting the courts to determine whether there has been failure to comply with those standards, that is, to continue to develop the common law of responsibility of corporate management unhampered by the legal fetters created at a time when courts were}

\(^{493}\) Supra note 42 (Dickerson Report) para.476 at 158.

\(^{494}\) Ibid. at 158 - 159.
preoccupied with enforcing "democratic" structures - particularly voting power - as the one real object of the law. (emphasis added)

It seems that Canadian courts' influence upon corporate management generally arises from their decisions taken to protect minority shareholders (or stakeholders) and the legal precedents such decisions establish.

Thus, although the "business judgement" and "internal management" rules are based upon a principle of judicial non-interference in internal corporate affairs, the oppression remedy has actually been drafted to encourage judicial solutions that can be extremely intrusive. The oppression remedy is still, relatively speaking, a new innovation. It remains unclear at the moment to what extent Canadian courts will be prepared to "rewrite" the business judgment or internal management rule over time, through their aggressive use of broad oppression remedies. Thus, whether the Canadian courts will have a significant or relatively modest influence over corporate control has yet to be determined.

5.4.2 In China

Broadly speaking, China adopts a civil law system. Judges under a civil law system are not allowed to make law through the function of interpretation. In addition, a judge is not bound by earlier judicial decisions in similar cases.

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495 The Civil law system historically was developed in continental Europe. It is a legal system with an emphasis on detailed statutory codes. Judges in civil law countries settle disputes according to principles laid down in a country's written statutes. The written statutes often specify in detail the legal rights and obligations of citizens and legal persons. In cases where written statutes do not specifically cover the point in dispute, the judge will try to apply general principles and justice set out therein.
China's legal system is also intermingled with its socialist doctrinal requirements. The Chinese Constitution stipulates that the people's courts are the judicial organ of the state and are responsible to and report to the National Peoples' Congress and its Standing Committee. The Standing Committee of the National People's Congress has the power to interpret laws. In practice, the Standing Committee of the National People's Congress either promulgates regulations to interpret laws or delegates its interpretation power to the Supreme People's Court to interpret questions involving the specific application of laws and decrees in court trials. The interpretation made by the Supreme People's Court regarding the specific application of laws and decrees in court trials is called "judicial interpretation." Judicial interpretation is different from case law in Canada. Such interpretation does not involve citing or relying upon judgments in earlier cases. It is rather like a summary of certain legal principles. Except for the Supreme People's Court, no other lower courts in China are authorized to issue judiciary interpretations. They may use, however, many avenues of receiving advice and direction from the Supreme People's Court on questions of law.

The specific function of Chinese judges is not enumerated by the Chinese laws. Practically, the major function of a judge is to collect evidence and examine witnesses so as to find out the facts. The duties of judges are to investigate, mediate and adjudicate by

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496 See Articles 123 and 128 of the 1993 Constitution of the People's Republic of China.

497 See Article 67 (4) of the 1993 Constitution of the People's Republic of China.

498 In Chinese, Si fa jie shi.

R. C. Brown has briefly described the Chinese legal system and judges in this way:

While certainly there are Chinese traditions, socialist doctrinal requirements in the legal system, the fact of its system being more inquisitorial than adversarial, its ‘trials’ not being recognized as a single event, its judges playing a larger role in collecting evidence and examining witnesses, the different role of lawyers (with little cross-examination and little pre-trial discovery) no juries, merely describes the traditional civil law approach as much as in Chinese approach.

Under this legal system, the courts in China naturally have little influence in China's corporate matters. In addition to China's legal system, other factors account for the fact that courts have little involvement in resolving corporate disputes. First, China's Corporate Laws lack legal remedies (such as the oppression remedy or appraisal remedy provisions found in the CBCA) for shareholders or stakeholders. Lack of defined legal remedies discourages parties from submitting corporate disputes to the courts. Second, the courts in China lack a tradition of being involved in resolving corporate disputes. China has had a relatively long period of a planning economy. State enterprises were the norm within the planning economy, and there was no need for state enterprises to

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500 It is noted that mediation only exists in the context of civil cases. In terms of criminal cases, judges are not allowed to mediate.

The conciliatory role played by the people's courts during the process of a civil action is a unique feature of the courts' function. Though the primary function of the court is to conduct a trial to settle disputes submitted to it, the court is also empowered to act as conciliator at different stages of the proceedings. Therefore, a potential litigant who approaches the people's court with a view to trial may end up with conciliation by the court. Please see Chapter VIII Mediation of Law of Civil Procedure of the People's Republic of China (Adopted by the fourth session of the seventh National People's Congress on 9th April 1991) Available online: Maryland University School of Law, ChinaLaw Website: <http://www.qis.net/chinalaw/lawtran1.htm> (date accessed: June 7, 1999).

approach the courts for resolving enterprise matters. Instead, the governments (central or local levels), through their administrative organs, served as mediators. Though under current economic reform there is increasing diversity of corporate ownership in China, the continuing dominance of state interests in corporations makes significant changes in court attitudes unlikely. Third, the lack of a tradition of court participation in corporate dispute resolution in turn leads to the phenomenon that the judiciary in China is not knowledgeable about business matters and corporate management. Fourth, according to China's traditional culture, Chinese people are shamed from accessing litigation. The concept of judicial process historically was almost unknown and a Confucian preference for harmony made litigation a shameful undertaking for parties to a dispute. Instead, mediation was viewed as the better means to settle civil disputes. This point will be further explored in the 5.5.2 below.

5.5 The Culture

Corporate control does not operate in a vacuum. It is shaped by, and in turn contributes to shaping, specific cultural and historical forces. The purpose of this section is to explore how cultural values in Canada and China shed light on corporate control mechanisms in Canada and China.

5.5.1 Canada

502 Confucianism is rooted in Chinese culture. Confucius, the founder of the doctrine (i.e. Confucianism) advocated that people should not access litigation. Persuasion, mediation, compromise and negotiation are the means to settle disputes. Please see Confucius, Confucius Analects online: University of Maryland, School of Law, Chinalaw Web Site, <http://www.qis.net/chinalaw/search1.htm> (date accessed: June 26, 1999).
For historical reasons, Canadian culture shares certain similarities with the cultures of other countries, mainly Great Britain, France and the United States. The European people, particularly the British, and Americans, have been remarkably successful over the last two hundred years in the fields of economic development, industrialization, science, and promoting the notion of a European moral order (whether this was advanced in terms of law or trade practice). The spread of European languages, and the predominance of European conceptual analysis in both the physical and social sciences greatly shaped the Canadian culture. The Canadian case law system was no exception, and was greatly influenced by judicial decisions in Britain and America. Capitalism is the main economic ideology shared by Canada, Western Europe and America. It is an ideology based on the recognition of private property rights. A social system based on capitalism therefore places a high priority on the protection of private property rights and recognizes "nonaggressive contractual exchanges between private property owners". The business corporation by its nature is a capitalist institution. It is the private property of investors that is fundamental to the structure of the corporation. Therefore, the existence and development of corporations are linked to the objective of pursuing profits and expanding shareholders' wealth. The duties and liabilities imposed on boards of directors and officers by the CBCA reflect, among other things, lawmakers' desire to improve corporate

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503 It is noted that at the time of Confederation, decisions from Canadian provincial courts could be appealed to the Judicial Committee of the Privy Council, in London, UK, for a final decision. The Judicial Committee's superior appellate jurisdiction over Canada did not end until 1933, for criminal appeals, and 1949, for civil appeals. The Supreme Court of Canada stands today as the final arbiter of legal disputes in the Canadian judicial system, and now enjoys the status of court of last resort. See "The Early Beginnings of the Court". The Supreme Court of Canada <http://www.scc-csc.gc.ca/brochure/english/html/Begin.htm> (date accessed: August 21, 1999).

performance and increase shareholders' value. The operation of corporations follows the rule of capitalist democracy: majority rule.

Closely connected with capitalism is individualism. Individualism rests on the premise that society does not have the right to restrict the individual's freedom to pursue happiness as he or she chooses to define it, subject to necessary constraints to prevent one individual from encroaching upon the rights of other individuals. The individual has the right to self-fulfillment, to self-actualization, and to the seeking of a personal identity. Influenced by this individualist ideology, the CBCA, by abolishing administrative discretion and reducing state intervention, creates a free and flexible business environment for people who intend to maximize their own property interests through business corporations.

In addition to sharing a common culture with Europe and the U.S., Canadians, over many generations, have built a distinctive and unique Canadian culture that distinguishes Canada from other countries. Based on a cosmological conception of culture, Schafer has summarized the characteristics of Canadian culture as:

- the intimate ecological relationship that Canadians have with the natural environment; the need to continuously create new communications technologies; the need for public-private cooperation; the ability to make concessions, compromises and work collaboratively; the willingness to

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505 It is noted that the CBCA also imposes certain liabilities upon directors in connection with employee wages and in relation to other matters such as improperly reducing capital or paying dividends and for providing unlawful financial assistance.


507 D. P. Schafer, The Character of Canadian Culture (Markham, Ont.: World Culture Project, 1990) at 55. The cosmological conception of culture refers to "the ordered whole". "The whole" refers to everything that exists in the cosmos - animal, vegetable, mineral and human; and "ordered" refers to the specific way in which the component parts of the whole are woven together around a central organizing principle or soul to produce an integrated entity.
search for *unity through equality and diversity rather than through assimilation and homogenization*, the commitment to a caring society with a high degree of material prosperity, *human compassion*, and social security; and etched on a much larger canvas, the capacity for cultural creativity and innovation.  

Canada in part because of the sparseness of its population and the vastness of its territory, and in part because of the rejection of the American economic and social model, has developed a liberal democracy in which government initiatives in the economy have been more readily accepted than they have been in the US. One of the characteristics of Canadian culture, as summarized above by Schafer, is "the need for public-private cooperation". In Canada, the creation of virtually every significant communications, economic, engineering, and social endeavor has arisen from collaboration between governments and private commercial corporations. Such cooperation both manifests and cultivates the ability of Canadians to compromise, make concessions, and demonstrate flexibility and collaboration. This may explain, at least in part, why Canadians tend to access litigation less than the U.S. people do and why the case law system in the area of corporate matters in Canada is less developed than that of the US. This may also explain why it has been said that Canadian people can "search

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508 *Ibid.* at 64. Schafer further explained that although these characteristics are discernible in other societies, no other country possesses them all, or possesses them in the same degree as Canada does. In this sense, they may be said to constitute Canadian cultural values.

509 The American model here refers to a system in which private enterprise, rather than state enterprise, is principally relied upon for the creation and development of virtually all significant communications, economic, engineering and social endeavors.

510 *Supra* note 506 at 45.

511 *Supra* note 507 at 68.

512 There are, of course, many other reasons that Canadians may appear to be less litigious. For instance, until recently, lawyer contingency fees have been forbidden in Canada (but not in the US); moreover, in
for unity through equality and diversity rather than assimilation and homogenization", and why Canadians have historically demonstrated a commitment to recognizing the rights, values and traditions of others.513

The high degree of human compassion in Canada, as pointed out by Mr. Schafer, is reflected in the fact that Canada has one of the most advanced systems of medical insurance coverage, unemployment insurance, old age pensions, equalization payments, regional subsidies, and family allowances in the world.514 And this same high degree of human compassion in Canada may also help to explain Canadian lawmakers' concern about minority shareholders' interests within the corporation. By equipping minority shareholders with legal weapons such as the oppression remedy, appraisal rights and cumulative voting, Canadian legislators have provided such shareholders with the tools they need not only to protect their own interests, but also with which they can influence or indirectly direct, corporate business.

In brief, Canadian culture, with capitalism and individualism at the centre, has come to value concession and human compassion. These values, in turn, restrict the development of an absolute (or pure) capitalism in Canada. With regard to corporate control in Canadian corporations, generally shareholder democracy based on capital is still the fundamental basis of corporate internal control. But at the same time, legal protections for minority shareholders provide an important balancing force which acts as a check against absolute majority rule.

513 Supra note 507 at 69 - 70.

514 Ibid. at 71 - 72.
5.5.2 China

China is a country with a long history. The influence of China's long past and the present state of flux during this reforming age all intermingle with some western concepts of capitalist democracy in today's Chinese culture. The language, the folklore, and the practices of government, business and interpersonal relations, and shareholding practices together become a part of today's Chinese culture and influence the way that corporations are controlled.

Confucianism is a distinctive feature of traditional Chinese society advocated by Confucius almost two thousand five hundred years ago. The philosophy of Confucianism deeply influences the behaviors of today's Chinese people. In addition to China, the East Asian countries and areas like Japan, Singapore, Korea, Vietnam, Hong Kong and Taiwan, all absorbed and refined Confucian values and concepts of authority.

The characteristics of Confucianism can be summarized as follows:

(1) The respect for age and hierarchy and an emphasis on obligations rather than rights within a society;

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515 Confucius was an itinerant Chinese scholar, philosopher, and lecturer over 2,500 years ago, in a time known as that of the Spring and Autumn period. The China of this time was not united, but was a collection of small states, at war or in dispute with one another, or struggling with barbarian tribes. Confucius set out with humility, resolution, and energy to find a ruler for whom he could work to address the great political questions of all ages - stability and order. However, his enthusiasm and success as a lecturer did not immediately yield the results he sought. It was not until the end of the 2nd Century BC, that Confucianism won recognition as the official creed of the nation. He emphasized virtue, learning and ritual as the means of ensuring that people lived in harmony with the natural order, which was also a moral order. China's long history largely determines the reputation of Confucius today. Those writings, however, which are ascribed to him or his influence have set a number of parameters which have been the dominant philosophical, social and political force in the evolution of Chinese civilization over more than two thousand years. His thoughts were collected in the book Analects.
Refer to infra note 517 at 3.

The orientation towards groups;
The importance of personal relationships;
The preservation of face; and
The emphasis on rule by virtue (with an emphasis on humanity), rather than the law.

The Confucian philosophy of respect for age and hierarchy cultivates the Chinese to respect authority and favor centralized decision making. The Chinese people have a high acceptance of hierarchy. This acceptance is embodied in China's administrative system. It also can be reflected in models of corporate control in China. A major feature of corporations in China is the high degree of state/public ownership concentration. The state or public institutions, at the top of the corporate hierarchy, are well protected by extraordinary shareholders' rights and majority rule under CCL. The state's interests in corporations are well secured. Minority shareholders, on the other hand, most of whom are individual shareholders, lack legal remedies to protect themselves. They more often have to comply with the majority shareholders' corporate decisions. However, the unbalanced relationship between majority shareholders and minority shareholders in corporations has been accepted by the Chinese people. Most Chinese people seem to be accustomed to respect this corporate hierarchy and do not appear to fully appreciate that, as one of the capital contributors, a shareholder has the right to protect his or her own interests against possible infringement by the corporation.

The respect for hierarchy in turn leads Chinese people to place greater emphasis on obligations within a society rather than upon rights. A consequence of a sophisticated emphasis on obligation developed over many centuries is a complex network of those obligations which crosses all levels of the society. The emphasis on obligation becomes a
major currency which facilitates political, social and community activity. In some ways this currency is more valuable and powerful than the monetary currency.\textsuperscript{517} It is one of the reasons that the awareness of private property rights has been so slow to develop in Chinese society and why Chinese lawmakers neglected minority shareholders' interests in corporate decision making during the time of drafting the CCL.

The orientation toward groups educates the Chinese people to have a consciousness of mutually interacting pressures to ensure that all members are caught within the network of obligations and share both responsibilities and rewards. This emphasis makes it difficult to develop systems to identify and reward performance on an individual basis. Such orientation toward groups favors labor participation in management and sharing responsibility for corporate decision making. This orientation surely contributed to the decision by Chinese lawmakers to borrow the German two-tier board structure for corporations.

The importance of personal relationships is the heart of Confucian philosophy. It emphasizes that one exists in relationship to others. The western starting point of individualism is alien to the traditional Chinese people. Five relationships were recognized in Confucianism, namely, relationships between sovereign and subject, father and son, older brother and younger brother, husband and wife, and friend and friend.\textsuperscript{518} As with the order of nature itself, these relationships, even those between friends, were constructed in hierarchical terms.\textsuperscript{519} The importance of personal relationships, especially the relationship

\textsuperscript{517} R. Little & W. Reed, \textit{The Confucian Renaissance} (Sydney: The Federation Press, 1989) at 54.

\textsuperscript{518} Note that in ancient Chinese society, women did not have any social status. That is why the relationships described by Confucius are centred upon men.

outside an individual's immediate family, within the context of business relations, binds people together both within and between business organizations and connects business people with government agencies. 520

The preservation of face (that is saving "face" as mentioned in 5.2.5 above) causes the Chinese to attach much greater importance to the views others hold of them than is found in other cultures. That is why the media may have some function in the disciplining of Chinese corporate managers. To some extent, however, the preservation of face restricts individual initiative and the evaluation of personal performance.

The emphasis on rule by virtue rather than by law is deeply reflected in the wording of Confucius, "lead the people by laws and regulate them by penalties and the people will try to keep out of jail but will have no sense of shame. Lead the people by virtue and restrain them by the rules of decorum, and the people will have a sense of shame and moreover, will become good." 521 Such philosophy is oriented toward shame through its emphasis on social norms and by reference to ideal types as models of behavior. The emphasis on rule by virtue maximizes the harmony and cohesion in society and tends to ensure that competition is pursued within a framework of established ceremony and courtesy that preserves social consensus. Such a major weakness in the rule of law may be little understood by westerners. In western legal professionals' eyes, the Chinese legal system is relatively backward. There is a complete absence of case reports, few judges, arbitrators and lawyers in proportion to its large population, few statutes, few


521 The wording was collected into Analects. See note 519 at 205, supra.
law schools and little legal literature. Mediation and compromise are the traditional channels for dispute settlement. Since Confucianism is basically a philosophy of harmony, peace and conciliation,522 the influence of Confucianism upon law for several thousand years has made the Chinese people reluctant to approach courts for asserting their rights. Mediation and compromise not only prevent one's "face" from being destroyed, but maintain friendship and other invisible advantageous business relationships.

Unlike Canadian culture, Chinese culture is group-orientated and essentially hostile to individualism.523 This group-orientation and essential hostility to individualism finds its setting in socialism. Confucianism and socialism both emphasize the state and society and minimize the merits of individuals, compared with the emphasis upon the individual favored in liberal-democratic capitalist states. The non-development of capitalism in China also means that there has been no alliance of merchants or trades to balance the state authorities.524

Fifty years of socialism525 in China have woven a fabric of values and beliefs that can only be called cultural even though Chinese socialism was built upon a pre-existing


524 The imbalance in the relationship between the state and individuals provides both the structural and the cultural bases for the human rights practices which are now the most contentious issues between China and the west, especially the U.S.

525 When talking about socialism, it seems that I cannot avoid Marx and Marxism. Marx made a great contribution to the social sciences by emphasizing the relationship between the distribution of power and wealth in a society and that society's prevailing ideas and values. Marx emphasized that ownership of property is the most important element separating the classes in a society. The upper classes, though few in number, controlled most of wealth in a society. Therefore, the means of livelihood and the very lives of the workers are controlled by the upper class. The legal mechanism of the state operated in large measure for the benefit of the upper class. The only way to change this situation, in Marx's view, was through violent overthrow of the upper class by a workers' revolution. See K. Marx, Capital (London: J.M. Dent Sons, Ltd., 1934).
base of compatible values and expectations. One of the key functions of a corporation (even a private corporation) in China is to fulfill, on behalf of the state, the socialist pledge of full employment. Although it is within management's power to hire and fire employees under China's Corporate Laws, managers of China's corporations and foreign investment companies find it almost impossible to exercise the right in practice without a lengthy haggle with either the local labor bureau or the industrial supervisory bureaucracy. Job security is a reward for loyalty rather than for performance.\textsuperscript{526} The practice of democratic centralism and the co-determination style in China's Corporate Laws have promoted a passive, responsibility-avoidance style of corporate internal control. Local managers and directors avoid making individual decisions and accepting responsibility for their actions.

While Confucianism educates the Chinese people to stay in a social context composed of a hierarchical group and emphasizes the importance of obligation, socialism continuously teaches the Chinese people the philosophy of collectivism, as opposed to individualism. These philosophies lead to the status of corporate control in today's China: individual shareholders never can hold majority shares and thus never can be the ultimate corporate controllers. That is to say, the private sector economy can never hold a predominant position within corporations under current Chinese laws and regulations. Not surprisingly, Professor Hoppe regards socialism as "an institutionalized interference with or aggression against private property and private property claims."\textsuperscript{527}

\textsuperscript{526} Supra note 317 at 35.

\textsuperscript{527} Supra note 504 at 2.
During the process of diversifying ownership, China can learn and benefit from Canadian cultural values with regard to the ability to compromise and make concessions without loss of recognition of the rights of others, in particular the rights of private property owners. Confucianism and socialist theory about compromise between the state and its people require individual private interests to be assimilated by state interests. This kind of compromise can be a huge impediment to building a credible capital market and attracting funds from the private sector in China. China is moving toward recognition of private economy in its public economy system. But such recognition should be based on equality rather than assimilation and homogenization. In this regard, China's Corporate Laws will help prevent the state and its public economy from encroaching upon the private economy by enhancing the protection of private property rights. For this reason, legal remedies protecting minority shareholders should be included in the CCL.

Confucian theory concerning humanity and socialist theory concerning full employment in a society also can be enriched by incorporating certain ideas from the Canadian culture regarding human compassion. Rather than eroding corporate efficiency by requiring full employment in corporations, humanity should be based on promoting effective and efficient corporate control so as to improve social welfare as a whole.

However, learning from Canadian cultural values does not mean an abolition of this country's own cultural values. It is beyond dispute that human fulfillment is more likely to come from the observance of obligations and productive activity than from an indulgence in exploiting rights coupled with the consumption of the fruits of other people's activity. An over-emphasis on individualism neglects the fact that the natural order of

\footnote{Supra note 517 at 106.}
one's life is a progression from dependence in childhood and education in youth, to productivity in adulthood, followed by more mature responsibility in age.\footnote{Ibid. at 106.} Maybe a middle ground, half-way between Confucianism and individualism; socialism and capitalism, is appropriate to China.

The complex external environment in which corporations operate exerts complicated influences upon corporate decision making. Each country has its own state situation, markets, banking system, legal system, and cultural values. There is no one model for creating and facilitating an external environment for improving corporate control that is suitable for every country without regard to those critical distinguishing characteristics and underlying values.
CHAPTER 6 CONCLUSION

The comparison of corporate control practices under Canadian federal corporate law (CBCA) and Chinese national corporate law (CCL and FIEs Laws) within distinctively different political, economic and social backgrounds shows the complex interplay of internal and external forces in shaping corporate decision-making in Canada and China.

The historical overview of the development of Canadian corporate law in the context of Canadian economic development demonstrates that, refined in a stable social environment, the CBCA has been much influenced by traditional British company law doctrine and US modern corporate law. China's Corporate Law, created during the age of China's economic reform aimed at building a socialist market economy, has been much influenced by the Chinese government's desire to employ the structure of the business corporation to facilitate the pooling of private capital from foreign investors and Chinese individual investors under the socialist regime.

Using the CBCA as a touchstone, through this comparative study, a number of key observations have been made. First, share structures provided by the CCL are similar to those provided for under the CBCA, however, the unique classification of shares in China according to an investor's identity reflects China's commitment to a socialist regime by providing a mechanism to monitor the amount of private capital in the Chinese equity market.

Second, the Canadian and the Chinese corporate markets are dominated by closely-held corporations, and public corporations in Canada and China both have high ownership concentration. High overlapping ownership and interlocking directorship are
also characteristics of the Canadian corporate market. China appears to tend to diversify its corporate ownership market through employee ownership.

Third, with respect to shareholders' controlling or influencing power over corporations, the comparative examination shows that shareholders' democracy, under the CBCA, is based on capital without sacrificing fair treatment for the minority shareholders. Minority shareholders are provided significant legal remedies under the CBCA. In China, CCL provides shareholders extraordinary statutory rights to determine corporate matters (particularly in the area of corporate strategic matters). In this sense, it thus appears that CCL accepts shareholders' capitalist democracy. But some special provisions under the CCL indicate that socialist doctrine cannot completely embrace capitalism within the structure of the corporation.

Fourth, while the CBCA adopts a one-tier board structure, CCL adopts a two-tier board structure for publicly-held corporations. Professional managers on the board are given a high degree of controlling power over corporate matters in Canada (unless there is a unanimous shareholder agreement providing otherwise), but managers can only have influencing power over corporate affairs in China. The separate supervisory board in Chinese corporations does not seem to result in a more efficient oversight function than that performed by outside directors on Canadian boards. The distinctive administrative sanction liability for directors and chair of the board and the relatively modest role of board of directors and managerial officers in Chinese corporations indicate that the vestige of the enterprise management model that prevailed under China's planning economy persists under China's corporate law.

530 CBCA s. 102 (1).
Fifth, employees in Chinese corporations are influential (particularly in areas relating to employee's interests in the corporation, like salary, welfare, working conditions, and safety protection) under China's Corporate Laws, while the CBCA seems to pay little attention to employees.531

Sixth, corporate internal control cannot be isolated from a corporation's external environment. This comparative study has indicated that laws and administrative facilities in China intervene more in corporate affairs than in Canada. Through a share issuing quota system, the Chinese government controls the amount of private capital on the Chinese capital market. Incorporation in China requires governmental approval while it is a right in Canada. The reason for greater administrative intervention in corporate affairs can be linked to China's fragile capital market, product/service market, and managerial service market, and to the restrictive role judges play in the Chinese legal system. Traditional Confucianism, emphasizing respect for hierarchy, obligations (rather than rights), orientation towards groups, and a disrespect for private property rights all contribute to a corporate control practice in today's China which is totally different from that of Canada where the prevailing culture emphasizes private property rights and individualism. In Canada, there is far less government administrative intervention in corporate matters and greater reliance upon markets and other non-legal institutions to regulate behaviors of market participants.

The above observations from both internal and external perspectives lead to the conclusion that corporate control practices under the CBCA rely more on contractual arrangements than on mandatory statutory provisions, give professional managers

531 An exception is in the CBCA s.119. Directors are jointly and severally liable to employees of the corporation for unpaid wages (that is, not exceeding six months wages).
significant discretion and equip minority shareholders with a high degree of protection through formal legal remedies. Canada's corporate control practices, therefore, represent a modified capitalist model, a model facilitating business without sacrificing equity and fairness.

China's Corporate Laws introduced the economic structure of the corporation into China and borrowed certain corporate control experiences from western capitalist countries but without sacrificing China's socialist regime. China's corporate control practices, therefore, represent a modified socialist model, a model merging modern corporate control and traditional socialistic enterprise management.

Corporate control practices vary across nations and cultures to meet changing conditions. There is no universal model of corporate control available to improve corporate performance within all competitive environments. Nor is there an ideal mode of corporate control that every country or corporation should emulate. Nevertheless, this general comparative study of corporate control under the CBCA and China's Corporate Laws aims to further an exchange of ideas for improving corporate performance in Canada and China.
Appendix I
Corporate Control: From Internal and External Perspectives
Chief Executive Officer holds the ultimate decision power. The managerial officers, though employees of the corporation, are hired professional managers. Board of Directors exercises no real decision power and serves as "rubber stamp" for the management. Shareholders are passive investors. They either sell out the shares they are holding, or keep silent in case of dissatisfaction to the management. Employees are implementing daily operation of the corporation according to the instructions issued by the officers and have no participation in the corporate management.

Canadian publicly-held corporations: Business Reality of Type A Corporations (widely held corporations)
This type of corporate internal power distribution more often exists in Canadian largest and financially important corporations. With Chief Executive Officer holds the final decision power, full-time managers effectively appoint the board of directors and select themselves management positions. Shareholders are the constituency as the "necessary rubber stamp" in accomplishing managers' long-term managerial goals. (Note)

(Note: B. Welling, Corporate Law in Canada: The Governing Principles, 2nd ed. (Toronto & Vancouver: Butterworths, 1991) at 301 and 302.
Canadian publicly-held corporations:
Business Reality of Type B Corporations
(public corporations with high ownership concentration)

Illustration:

Corporate decision-making power is in the hand of a single shareholder or a small group of controlling shareholders. The controlling shareholder/shareholders either legally control the corporation (own directly or indirectly 50% of voting shares) or effectively control the corporation (own directly or indirectly 20% - 49.9% of the shares).

Board of directors note: a single shareholder or a small group of controlling shareholders very like elect themselves or their nominees as directors and managers. If so, they have controlling power over the corporation.

Managerial officers implement the strategic planning issued by the controlling shareholder/shareholders.

Other shareholders are passive investors and generally have no real power.

Employees are implementing daily operation of the corporation according to the instructions issued by the officers and have no participation in the corporate management.
It is the most numerous corporations in Canada. Most of them are small family-run corporations.

A distinct feature is that the role of Shareholder, Director, and Managerial Officer is played by one person/family. Such person/family not only holds all the shares of the corporation, but also elects himself/herself as director and participates strategic and daily management of the corporation.

The corporation may hire other people as Employees. Employees generally have no power at all in this type of corporations (note).

Illustration:

Canadian closely-held corporations:
Business Reality of Type C Corporations
(particularly small size close corporations)

CBCA s.102 (1):
"Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation."

CBCA s.121(a):
"Subject to the articles, the by-laws or any unanimous shareholder agreement, the directors may designate the offices of the corporation, appoint as officers persons of full capacity, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except powers to do anything referred to in subsection 115(3)."
Currently, most public corporations in China are not purely private corporations. This chart reflects the State (represented by central or local people's governments) legally controls (directly or indirectly owns over 50% voting shares) or effectively controls (own directly or indirectly 20% - 49.9% of the shares) the corporation.

Other Shareholders like Legal Persons Shareholders or Individual Investors as minority shareholders have little controlling power. Board of Directors generally has no real power and more often follow the state decision. Managerial Officers play the function of implementing corporate decisions. Supervisory Board tends to be passive since certain defects contained in the provisions under CCL. Employees have certain influences in the area of certain labor related matters (e.g. employment, labor safety, salary and welfare, etc.)
Chinese Public Corporations:  
**Business Reality of Type B Corporations**  
(corporations with high ownership concentration on the side of legal persons)

Illustration:

Different from the Chart III - A, in this case, the **State** is a minority shareholder.

**Legal Persons** which hold majority voting shares exercise decision power.

In terms of minority shareholders, the state discretion is more easily to be noted by the majority shareholders. But the **Individual Investors** are in a disadvantageous position.

The role of **Board of Directors**, **Managerial Officers**, **Supervisory Board** and **Employees** generally have the same power as demonstrated in Chart III - A.
Type C corporations more often are incorporated from an old state-owned enterprise. It is a private proceeding.

Shareholders are composed by the state, legal persons and employees. Supervisory Board might have certain influences on corporate direction since the board members are purely from shareholders (since employees are turned into shareholders). Board of Directors implement the strategic decisions made by the shareholders. But they have recommendation power. Managerial Officers handle day-to-day business.
Board of Directors is legally provided as the highest organ in the corporation. But in reality, since the structure of sino-foreign investment enterprises in China is like a limited partnership in the west, it is the investors, i.e. the Chinese and foreign investors, who exercise power.

Board members are appointed by investors. The number of directors that each party can appoint is usually according to the capital Chinese and foreign investors contributed.

General Manager as a head of Managerial Officers is responsible for day-to-day corporate matters. Managerial Officers report to the General Manager.

Employees generally have limited influence power to corporate decisions. Employees through the trade union in the corporations to influence the corporate decision in the area of labor related matters.
Chinese Corporations: The Legal Theory Under CCL (public and closely-held corporations)

Illustration:

In theory, according to CCL, Shareholders' Meeting is the highest organ in the corporations. According to CCL, the Shareholders' Meeting handles corporate strategic matters.

Supervisory board, composed by the shareholders and employees, is the supervisory institution which supervise the board members, managerial officers and their delegates.

Board of Directors has recommendation power to the shareholders' meeting in the area of corporate strategic matters. Legally, under CCL, it is basically in charge of daily corporate matters.

Managerial Officers implement the daily operation of the corporation in accordance with CCL.

Employees have certain influence power to the corporate decision relating to labor matters.
III - F.

Illustration:

Board of Directors is legally provided as the highest organ in the corporation.

General Manager as a head of Managerial Officers is responsible for day-to-day corporate matters. Managerial Officers report to the General Manager.

Employees generally have limited influence power to corporate decisions. Employees through the trade union in the corporations to influence the corporate decision in the area of labor related matters.

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